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UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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IN RE OPTIMAL U.S. : CASE NO.: 10-cv-4095 (SAS)  
LITIGATION :

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DEPOSITION OF BERNARD L. MADOFF

(Taken by the Plaintiffs)

Butner, North Carolina

August 7, 2012

7:51 a.m.

Reported by: Lisa A. DeGroat, RPR  
Notary Public

<p style="text-align: center;">2</p> <p style="text-align: center;">1 APPEARANCES</p> <p>2 For the Plaintiffs:</p> <p>3 JAVIER BLEICHMAR, Esq.</p> <p>4 ALAN I. ELLMAN, Esq.</p> <p>5 Labaton Sucharow, L.L.P.</p> <p>6 140 Broadway</p> <p>7 New York, New York 10005</p> <p>8 (212) 907-0887</p> <p>9 jbleichmar@labaton.com</p> <p>10</p> <p>11 For the Defendants:</p> <p>12 SHAWN PATRICK REGAN, Esq.</p> <p>13 GUSTAVO J. MEMBIELA, Esq.</p> <p>14 Hunton &amp; Williams, L.L.P.</p> <p>15 200 Park Avenue</p> <p>16 New York, New York 10166</p> <p>17 (212) 309-1046</p> <p>18 sregan@hunton.com</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p> <p style="text-align: center;">DEPOSITION OF BERNARD L. MADOFF, taken by</p> <p>the Plaintiffs, at the Federal Correctional</p> <p>Institution - Butner Medium I, Old N.C. Highway 75,</p> <p>Butner, North Carolina, on the 7th day of August,</p> <p>2012, at 7:51 a.m., before Lisa A. DeGroat,</p> <p>Registered Professional Reporter and Notary Public</p> <p>of the State of North Carolina.</p>	<p style="text-align: center;">4</p> <p style="text-align: center;">1 STIPULATIONS</p> <p>2 Before testimony was taken, it was stipulated</p> <p>3 by and between counsel representing the respective</p> <p>4 parties as follows:</p> <p>5 1. That any defect in the notice of the</p> <p>6 taking of this deposition, either as to time or</p> <p>7 place, or otherwise as required by statute is</p> <p>8 expressly waived, and this deposition shall have the</p> <p>9 same effect as if formal notice in all respects as</p> <p>10 required by statute had been given and served upon</p> <p>11 the counsel in the manner prescribed by law.</p> <p>12 2. That this deposition shall be taken for</p> <p>13 the purpose of discovery or for use as evidence in</p> <p>14 the above-entitled action, or for both purposes.</p> <p>15 3. That this deposition is deemed opened and</p> <p>16 all formalities and requirements with respect to the</p> <p>17 opening of the same, expressly including notice of</p> <p>18 the opening of this deposition, are hereby waived,</p> <p>19 and this deposition shall have the same effect as if</p> <p>20 all formalities in respect to the opening of the</p> <p>21 same had been complied with in detail.</p> <p>22 4. That the undersigned, Lisa A. DeGroat,</p> <p>23 Registered Professional Reporter and Notary Public,</p> <p>24 is duly qualified and constituted to take this</p> <p>25 deposition.</p> <p>5. Objections to questions, except as to the</p> <p>form thereof, and motions to strike answers need not</p> <p>be made during the taking of this deposition, but</p> <p>before any judge or any court of competent</p> <p>jurisdiction for the purpose of ruling thereon, or</p> <p>at any other hearing or trial of said case at which</p> <p>said deposition might be used, except that an</p> <p>objection as to the form of a question must be made</p> <p>at the time such a question is asked or objection is</p> <p>waived as to the form of the question.</p> <p>6. That the signature of the witness to the</p> <p>deposition is hereby reserved.</p> <p>7. That the Federal Rules of Civil Procedure</p> <p>shall control concerning the use of the deposition</p> <p>in court.</p>
<p style="text-align: center;">3</p> <p style="text-align: center;">1 CONTENTS</p> <p>2</p> <p>3 The Witness: Bernard L. Madoff Examination</p> <p>4 By Mr. Bleichmar . . . . . 5</p> <p>5</p> <p>6</p> <p style="text-align: center;">7 INDEX OF THE EXHIBIT</p> <p>8</p> <p>9 Plaintiffs' Identified Marked</p> <p>10 Exhibit 1 Picture of the board of directors</p> <p style="padding-left: 100px;">of Banco Santander, 1 pg. 166 166</p> <p>11</p> <p>12</p> <p>13</p> <p>14</p> <p>15</p> <p>16</p> <p>17</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p>	<p style="text-align: center;">5</p> <p style="text-align: center;">1 PROCEEDINGS</p> <p>2 Whereupon,</p> <p>3 BERNARD L. MADOFF,</p> <p>4 having been duly sworn,</p> <p>5 was examined and testified as follows:</p> <p>6 DIRECT EXAMINATION BY COUNSEL FOR PLAINTIFFS</p> <p>7 BY MR. BLEICHMAR:</p> <p>8 Q. All right. Good morning, Mr. Madoff.</p> <p>9 Could you, please, state your name for the</p> <p>10 record?</p> <p>11 A. Bernard Madoff.</p> <p>12 MR. BLEICHMAR: And, because there's been</p> <p>13 no introductions by the usual videographer, I</p> <p>14 will lay out on the record, my name is Javier</p> <p>15 Bleichmar. With me is Alan Ellman, from Labaton</p> <p>16 Sucharow.</p> <p>17 We represent the plaintiffs in the -- in</p> <p>18 re: Optimal Securities litigation in the United</p> <p>19 States Federal District Court, in the Southern</p> <p>20 District of Manhattan.</p> <p>21 And, Mr. Regan, if you'd like to</p> <p>22 introduce --</p> <p>23 MR. REGAN: Sure.</p> <p>24 MR. BLEICHMAR: -- counsel for the</p> <p>25 defendants.</p>

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6	<p>1 MR. REGAN: Shawn Regan, Hunton &amp; Williams.  2 We represent the defendants in this lawsuit.  3 With me is Gus Membiela, also from Hunton &amp;  4 Williams. Gus is in our Miami office. I'm in  5 our New York office. And I think that's it.  6 Before we go any further, I should just  7 say, we want to designate the transcript as  8 confidential, subject to review. Designated as  9 confidential in its entirety at this point,  10 subject to further review.  11 MR. BLEICHMAR: Right. I mean, we  12 obviously object to the designation, but the  13 procedures are set --  14 MR. REGAN: Right.  15 MR. BLEICHMAR: -- in the protective order.  16 MR. REGAN: Right.  17 BY MR. BLEICHMAR:  18 Q. Mr. Madoff, have you been deposed before?  19 A. Yes.  20 Q. And when were you deposed approximately?  21 A. Oh, years ago.  22 Q. Were you deposed as a -- as a party to a  23 lawsuit or --  24 A. No. As a witness.  25 Q. You were a third-party witness?</p>	8	<p>1 object to my questions. They're preserving their  2 objections. You may still answer the questions, but  3 we need to provide defense counsel an opportunity to  4 object.  5 One last thing. You're not represented by  6 counsel here; correct?  7 A. No.  8 Q. And you understand that I am not your  9 counsel; correct?  10 A. Correct.  11 Q. Let me ask you first a few background  12 questions about your -- your business.  13 A. Uh-huh.  14 Q. Your former business was called Bernard L.  15 Madoff Investment Securities; correct?  16 A. That's right.  17 Q. And can you describe generally what -- and,  18 actually, let me step back.  19 Can we refer to that as BMIS for short?  20 A. Yeah.  21 Q. And can you describe briefly what BMIS did?  22 A. Well, we originally started out as a  23 market making firm and a proprietary trading  24 firm in 1960. And there was a small division  25 that was a money management firm that was headed</p>
7	<p>1 A. Expert witness. Right.  2 Q. An expert witness?  3 A. Yeah.  4 Q. And was this a civil litigation?  5 A. Yes.  6 Q. And what capacity of expert witness were  7 you?  8 A. Trader. As an expert trader.  9 Q. So you're a little bit familiar with --  10 with the mechanics of a deposition; correct?  11 A. Yes.  12 Q. I'm going to ask you to make sure that all  13 of your responses are verbal. Otherwise, the court  14 reporter cannot transcribe them.  15 Also, please make sure you let me finish my  16 question before you begin your answer. That way the  17 court reporter doesn't have to step on itself.  18 Do you understand?  19 A. Yeah.  20 Q. If you -- if you need a break, please, let  21 us know.  22 A. Uh-huh.  23 Q. We can take a break whenever it's  24 convenient for you.  25 At some point in time defense counsel may</p>	9	<p>1 up by myself, my sons and my brother, ran the  2 market making and proprietary side of the  3 business.  4 We then became a registered investment  5 advisor in 2006, and that business was basically  6 separate from the market making proprietary  7 business. Although, it was under the same  8 heading and under the same umbrella.  9 Q. When you referred to the market making  10 business, for purposes of the jury, that is not  11 familiar with these trading terms, can you just  12 describe what market making entails?  13 A. Market making is basically a wholesale  14 operation that is similar to a specialist  15 operation on the floor of an exchange.  16 We actually were the largest competitor  17 of the New York Stock Exchange, and we  18 transacted about 400,000 transactions a day. We  19 represented close to ten percent of all of the  20 trading in U.S. equities.  21 What a market maker does is stand -- is  22 registered with the SEC and the NASD, now called  23 FINRA, as a market maker. He then is  24 responsible for maintaining an orderly liquid  25 market in a list of securities that he registers</p>

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10	<p>1 for.</p> <p>2 We traded the complete 500 S&amp;P</p> <p>3 securities, as well as about 200 NASDAQ</p> <p>4 securities as well. We carried an inventory,</p> <p>5 which at times could be as much as a billion</p> <p>6 dollars.</p> <p>7 And our clients are primarily all of the</p> <p>8 discount firms, like Schwab and Fidelity, and</p> <p>9 the retail brokerage firms, anywhere from</p> <p>10 Merrill Lynch to Goldman Sachs and so on.</p> <p>11 Q. When you say you were registered with the</p> <p>12 SEC, is that registration as a broker-dealer?</p> <p>13 A. A broker-dealer. Correct.</p> <p>14 Q. So is the market -- when you're referring</p> <p>15 to the market making business, is that effectively</p> <p>16 what's also known as the broker-dealer side of the</p> <p>17 business?</p> <p>18 A. Yes.</p> <p>19 Q. And what types of clients did BMIS have in</p> <p>20 the broker-dealer side of the business?</p> <p>21 A. We had a few hundred -- about maybe 300</p> <p>22 other broker-dealers. As I said, from --</p> <p>23 anywhere from Fidelity and Schwab and regional</p> <p>24 firms, like A.G. Edwards, to full-service firms,</p> <p>25 like Morgan Stanley, Goldman Sachs and Merrill</p>	12	<p>1 advisors, as opposed to just a broker-dealer.</p> <p>2 The main reason that was was because</p> <p>3 investment -- once you register as an investment</p> <p>4 advisor, you're subject to the fraud statutes.</p> <p>5 So all brokerage firms, without exception, you</p> <p>6 know, only register as an investment advisor if</p> <p>7 deemed to be necessary based upon the</p> <p>8 regulations which require you to register if you</p> <p>9 do a certain kind of business.</p> <p>10 When that happens, most firms will</p> <p>11 choose to build another entity where they will</p> <p>12 maintain the investment advisement business</p> <p>13 under that umbrella of the investment advisor,</p> <p>14 which is separate from the broker-dealer.</p> <p>15 There is an exemption for broker-dealers</p> <p>16 to not register as an investment advisor, which</p> <p>17 was the exemption that we followed, which is an</p> <p>18 exemption that says as long as you did not have</p> <p>19 what they deem special compensation, in other</p> <p>20 words, you weren't charging a fee, other than a</p> <p>21 commission, which was incidental to the</p> <p>22 transaction, then you -- and you weren't doing a</p> <p>23 discretionary account, and that discretion was</p> <p>24 exempt.</p> <p>25 The definition of discretion was where</p>
11	<p>1 Lynch.</p> <p>2 We also had a number of retail clients.</p> <p>3 Some of them were very large investors, but you</p> <p>4 would classify it as institutional-type</p> <p>5 investors. Although, they were individuals or</p> <p>6 wealthy families.</p> <p>7 And then we also had -- we started out</p> <p>8 investing for basically family and friends,</p> <p>9 doing a bona fide arbitrage strategy, which is a</p> <p>10 strategy of trading convertible securities in an</p> <p>11 arbitrage fashion.</p> <p>12 We never did -- well, we primarily did</p> <p>13 not do any retail business, in the sense of if a</p> <p>14 client wanted to buy General Motors or IBM, then</p> <p>15 we would not handle that transaction.</p> <p>16 We did handle transactions for some of</p> <p>17 these large investors outside of arbitrage,</p> <p>18 which were primarily hedge type of transactions</p> <p>19 in high capital vision and securities.</p> <p>20 Q. When you refer to investing for families</p> <p>21 and friends, is that what has been referred to as</p> <p>22 the investment advisory side of the business?</p> <p>23 A. No. You have to understand that the</p> <p>24 brokerage industry is basically -- has always</p> <p>25 had an issue with registering as investment</p>	13	<p>1 you -- you could have discretion for a time in</p> <p>2 place of execution, but you couldn't choose the</p> <p>3 security. If you followed those rules, then you</p> <p>4 fell under the exemption of a -- of not having</p> <p>5 to register as an investment advisor.</p> <p>6 And we chose that exemption for 50 years</p> <p>7 or 40 some odd years. Then in the -- starting</p> <p>8 in the 2000's the SEC, because of the growth of</p> <p>9 hedge funds and the problems that were</p> <p>10 developing, wanted firms to register as</p> <p>11 investment advisors.</p> <p>12 That was met with a huge amount of</p> <p>13 opposition from the industry, which I was part</p> <p>14 of, because I was at that time on various</p> <p>15 committees and boards in the industry.</p> <p>16 And the fight went on for a number of</p> <p>17 years. Primarily because of the reason that I</p> <p>18 stated, about firms not wanting to have to</p> <p>19 register as an investment advisor, which</p> <p>20 included even hedge funds, who had no</p> <p>21 registration, even as broker dealers.</p> <p>22 The -- there was an issue in -- that</p> <p>23 started, I guess, in maybe 2004 or '05, where</p> <p>24 the SEC went to some of our clients, and we were</p> <p>25 executing trades for hedge funds, large hedge</p>

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<p>1 funds. And because those firms were deeming us 2 to be an advisor on their offering documents, 3 the SEC chose to take the position that they 4 felt that we should register. 5 We objected to registering at that time, 6 and we employed the firm of Wilmer Cutler, who 7 was by far supposed to be the expert in 8 securities litigation at that time. 9 And I had known partners in the firm, 10 primarily Brandon Becker, through my work with 11 the SEC and the NASD, who was the past head of 12 market regulation. 13 And we -- we got into negotiations with 14 the SEC as to whether we should register or not. 15 It was Wilmer Cutler's position that we did not 16 have to register because of the type of business 17 we were doing and the exemptions that existed. 18 The SEC, you know, objected to that. 19 They felt that -- that we were using discretion 20 with a number of -- of clients, including the 21 hedge funds. 22 The -- Wilmer Cutler said, no, we 23 weren't, because of the documents that we 24 required all of our clients, both small and 25 large, to sign that basically stated that we are</p>	<p>1 forms, with the assistance of Wilmer Cutler and 2 their investment management people. 3 And took the position that we only had a 4 certain number of discretionary accounts, which 5 we put on the forms. And the other accounts 6 were nondiscretionary accounts. 7 Some of the forms -- some of the funds, 8 because of documents that they had filed and 9 wouldn't change, we considered them to be 10 investment advisory clients. Others we did not. 11 The SEC then -- they lost in court a 12 case against the hedge funds that required -- 13 and that said you did not have to register. 14 At that time Wilmer Cutler called me up 15 and said, you can give up your registration, if 16 you so choose, because it's clear now the courts 17 have decided they're -- you're not required to 18 register. 19 At that point we said, look, we've 20 already gone through the effort. This is going 21 to be an ongoing battle with the SEC. We're 22 going to keep the registration. 23 And all of our investment advisory 24 business, with the funds and those clients that 25 were -- were done -- actually, at that stage</p>
15	17
<p>1 not authorized discretion on their accounts, 2 other than time and place, which was allowed, 3 and that we used the same model type of 4 transaction for all of our clients, large or 5 small, except a handful of large clients, which 6 we did not have discretion for. And we used to 7 get the instructions from those individual 8 clients. Anyhow -- 9 Q. So you registered as an investment 10 advisor -- 11 A. Well, we -- 12 Q. -- in 2006? 13 A. We -- right. In 2006 there was a 14 conference call for probably two -- two or three 15 hours between the SEC, Wilmer Cutler and myself, 16 where they argued this issue. 17 The conference call ended basically with 18 nothing being resolved, other than the fact that 19 we were not going to register. 20 The -- I then decided in December of 21 2006, based upon rumblings from the SEC about 22 they were going to force everybody to register 23 anyhow, to register as an investment advisor. 24 We, in fact, did register as an 25 investment advisor in 2006, filled out the</p>	<p>1 everything was pretty much done through the 2 investment advisory side. 3 Q. At the beginning you mentioned that BMIS 4 had essentially three aspects to its business, 5 market making, proprietary trading and money 6 management; right? 7 A. Correct. 8 Q. And this aspect of the registration as an 9 investment advisor is the aspect that refers to the 10 money management business; is that right? 11 A. Yes. 12 Q. Could you describe briefly just the 13 proprietary trading part of the business? 14 A. Proprietary trading is similar to the 15 market making business, except they're -- 16 it's -- it's where you're trading solely for 17 your own account as principal. You're not 18 trading as agent for your other clients. 19 So primarily your firm allocates a 20 certain amount of capital, which is deemed to be 21 risk capital, where you maintain an inventory 22 for either long-term or short-term. 23 And was -- was typical in our firm, that 24 inventory was always hedged using various 25 derivative products, like options and futures</p>

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18	<p>1 and convertibles to -- to limit the risk.</p> <p>2 Q. And was that generally a profitable</p> <p>3 business?</p> <p>4 A. Yes. It was a very profitable business,</p> <p>5 as was the market making business, but</p> <p>6 regulations required you to have -- to wall off</p> <p>7 and have what's in the industry known as Chinese</p> <p>8 walls between the different divisions of the</p> <p>9 business.</p> <p>10 So we had separation basically between</p> <p>11 three businesses. We had the market making</p> <p>12 business, which was run by one of my sons, Mark</p> <p>13 Madoff. And there was a proprietary business,</p> <p>14 which was run by my son, Andy Madoff.</p> <p>15 My brother basically was the compliance</p> <p>16 officer on both of those -- of those firms.</p> <p>17 The money management side, the</p> <p>18 investment advisory business was run by me. I</p> <p>19 was also the compliance officer of that, of the</p> <p>20 money management or the investment advisory</p> <p>21 business.</p> <p>22 They used different computer systems.</p> <p>23 There was -- we had different managers. The</p> <p>24 rules were -- that we followed were based upon</p> <p>25 an SEC no action letter that basically said you</p>	20	<p>1 A. Yeah. It was just a broker-dealer</p> <p>2 registration. It was, you know, with -- that</p> <p>3 everybody had to have to register.</p> <p>4 Q. And was it allowed to hold certain specific</p> <p>5 securities or any types of securities?</p> <p>6 A. Any types of securities.</p> <p>7 Q. So was BMIS allowed to hold treasuries?</p> <p>8 A. Yes.</p> <p>9 Q. Who did the broker-dealer settle and clear</p> <p>10 through?</p> <p>11 A. We cleared ourselves.</p> <p>12 Q. So it was -- it was self-clearing?</p> <p>13 A. It was a self-clearing firm from -- from</p> <p>14 inception.</p> <p>15 Q. And what does that mean, that it was</p> <p>16 self-clearing?</p> <p>17 A. In other words, we had a back office</p> <p>18 operation that was capable of receiving and</p> <p>19 delivering securities, you know, through -- with</p> <p>20 your own bank accounts.</p> <p>21 You didn't have what they called an</p> <p>22 omnibus or a clearing arrangement with another</p> <p>23 firm, like a Bear Stearns or Merrill Lynch, who</p> <p>24 actually cleared the firms, and you just</p> <p>25 executed -- the trades, and you just executed</p>
19	<p>1 had to have separate managers, separate P&amp;Ls for</p> <p>2 the divisions.</p> <p>3 There could be no communications between</p> <p>4 the managers or the individuals in those</p> <p>5 divisions. So they operated basically as three</p> <p>6 separate firms. They could operate under the</p> <p>7 same trading room.</p> <p>8 Also, that was basically a no action</p> <p>9 letter, because before that time the industry</p> <p>10 had sort of absurd types of arrangements where</p> <p>11 they would have a locked room in the middle of</p> <p>12 the trading room, and that was deemed to be --</p> <p>13 basically First Boston filed for a no action</p> <p>14 letter that said this is insane, to have that</p> <p>15 type of a system.</p> <p>16 So that was when the SEC said, okay.</p> <p>17 Fine. As long as you have separate management</p> <p>18 and P&amp;L, you can all have it under -- under one</p> <p>19 roof.</p> <p>20 Q. And the market making and proprietary</p> <p>21 trading business were clearly part of the</p> <p>22 broker-dealer business; correct?</p> <p>23 A. Yes.</p> <p>24 Q. And was there a specific type of</p> <p>25 registration that the broker-dealer had?</p>	21	<p>1 them.</p> <p>2 We had some clearing arrangements with a</p> <p>3 London operation through Barclays Bank in</p> <p>4 London. That was a separate entity, a separate</p> <p>5 broker-dealer, registered with the FSA in</p> <p>6 London, and was a member of the London Stock</p> <p>7 Exchange.</p> <p>8 And that was formed in 19 -- I think it</p> <p>9 was '83 or '84. That had its own capital.</p> <p>10 Q. When you -- when you first started the</p> <p>11 firm, I think you said, approximately 1960?</p> <p>12 A. That's correct.</p> <p>13 Q. That was clearly before the advent of all</p> <p>14 of this technological advancement; right?</p> <p>15 A. That is correct.</p> <p>16 Q. Could you describe for me mechanically how</p> <p>17 the clearing process worked when the securities were</p> <p>18 actually physical?</p> <p>19 A. They were done -- securities were</p> <p>20 handled by messengers. In other words, if you</p> <p>21 bought 100 shares of IBM from Merrill Lynch, it</p> <p>22 was a seven-day settlement.</p> <p>23 Seven days after you purchased the</p> <p>24 transaction -- well, immediately you would send</p> <p>25 out a confirmation, which is, you know, a</p>

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22	<p>1 document that basically mirrors what the trade 2 was, the monies involved. 3 On settlement day, which was seven days 4 originally, Merrill Lynch would deliver the 5 securities over what's called a window to your 6 back office operation. 7 And you would pay for those securities 8 either with a certified check or a regular check 9 from the bank, or they might take it to be 10 certified and so on. 11 Q. You would hold physically the securities? 12 A. You would physically hold the securities 13 in -- in your vaults, bank vaults or your own 14 vault, depending upon what your -- what your 15 capability was. 16 Q. And if you weren't a self-clearing 17 organization, did that mean that that exchange of 18 the security and the cash occurred somewhere else? 19 A. Yes. You would -- you had a -- normally 20 you'd have a clearing arrangement with a 21 clearing firm, like a Bear Stearns or a Merrill 22 Lynch, who would act as your back office. 23 The securities from -- that you had 24 bought from Merrill Lynch would be delivered to 25 the clearing firm of -- for your account.</p>	24	<p>1 And at that time, you know, as I say, 2 you were doing a few trades a day. So it was 3 not that difficult, but most -- there were many, 4 many firms that had capital in the thousands of 5 dollars. 6 To give you an example, as recently as 7 the '50s Morgan Stanley's total capital was 15 8 million dollars, which more people are shocked 9 to hear that today. So it was just a totally 10 different -- a different business. 11 Q. So once technology became more prevalent in 12 the financial world, how did the clearing mechanism 13 change? 14 A. Well, I guess you could blame me for 15 that partly, because -- which I get blamed for 16 everything it seems. 17 Sometime in the '70s there was a 18 paperwork crisis, where knowing -- the volumes 19 of business grew, and no one knew -- no one 20 knew -- no one knew what was happening in the 21 industry. People working 24 hours a day to try 22 and sell their trades. 23 And there were five of us that came up 24 with the concept of having a centralized 25 clearing organization. That was a very</p>
23	<p>1 You would have money on deposit with 2 that clearing firm, and the transaction would be 3 handled completely by them. And they would 4 typically hold the securities in safekeeping 5 for -- for you. 6 Q. Was it customary for firms like BMIS in the 7 early days, in the 1960s and '70s, to be 8 self-clearing firms? 9 A. Yeah, yeah. It was -- the business was 10 very, very different. It was much, much smaller 11 scale. It was a time that there were many, many 12 boutique -- what you would now call boutique 13 type of firms. 14 We were unique when we registered, 15 because we registered with less than \$500 worth 16 of capital, which was something that the SEC had 17 never seen to that point. The -- 18 I was in law school at the time, was 19 primarily doing business with a handful of 20 family and friends. It was not uncommon to have 21 small firms like that, but, as I say, \$500 22 probably stretched the imagination, to the point 23 that the SEC required me to have an audience 24 with them to make sure that I was for real, 25 which I did. And they couldn't object to it.</p>	25	<p>1 controversial position. 2 Q. Which -- who were the five, out of 3 curiosity? 4 A. Bennett, who was from A.G. Edwards &amp; 5 Sons. I think it was Charlie Allen, from 6 Allen &amp; Company. I think Oppenheimer was 7 involved. 8 And I don't recall the others any 9 longer. My brain is somewhat fried with 10 everything that's happened here. 11 So -- but at that time the -- the 12 clearing -- the industry was basically handled 13 by either large brokerage firms, like Bear -- 14 like a Bear Stearns or Merrill Lynch, or large 15 banks, like Chemical Bank, you know. 16 Most of those banks have now been merged 17 into other ones, but -- Manufacturers Hanover. 18 And also cleared for brokerage firms. 19 So they saw a centralized clearing and 20 depository organization as a big threat to their 21 business, which it was. 22 Well, we -- we, you know, struggled 23 through a period of time where the SEC realized 24 that this -- the industry had to change, in 25 spite of the objections by the turf wars that</p>

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26	<p>1 were going on between the banks.  2 And we formed a clearing organization  3 called National Securities Clearing Corporation.  4 And the idea of that -- that business was to  5 basically act as a central clearing organization  6 for firms, so that if we bought stock from  7 Merrill Lynch, Merrill Lynch would deliver those  8 securities to the clearing corporation.  9 The clearing corporation that same day  10 would bill us for the transaction. We would  11 have on deposit certain monies that they would  12 hold in escrow for us to assure that we were --  13 you know, in a crisis mode we're able to sell  14 the trades.  15 But the trades basically still at the  16 end -- on the settlement day, on seven days,  17 we -- the clearing corporation would let us  18 know, okay. You have net settlements, net buys  19 of X number of dollars. And we would -- we  20 would pay them by wiring money in to settle the  21 transactions.  22 And pretty much, with the SEC's  23 prodding, everybody joined the clearing  24 corporation, providing it had enough capital  25 to -- to apply as a member. The --</p>	28	<p>1 trades within one day.  2 And when you buy securities now, I may  3 buy from Merrill Lynch, and I may sell to  4 someone else. At the end of the day you never  5 even know who you bought and sold the securities  6 from, because the clearing corporation is on  7 the -- is on the -- is the counterparty to the  8 transaction.  9 Q. And the clearing corporation today in this  10 instance was DTC?  11 A. Yes.  12 Q. So what is the difference between clearing  13 through DTC and having self-custody?  14 A. Well, there virtually is very little  15 self-custody anymore in the industry today,  16 because of the fact that all of the business is  17 done through the clearing corporation.  18 So the clearing corporation holds those  19 securities as a custodian for its -- for its  20 members.  21 The only time you would hold custody in  22 securities in your own vault would be if, in  23 fact, it was an instrument that was not handled  24 by DTC.  25 Government bonds were -- treasury bonds</p>
27	<p>1 Then that morphed into the Depository  2 Trust Company, which now it's one organization.  3 You know, referred to as DTC, where the --  4 everything is done through -- through one  5 organization.  6 I served as -- as chairman of the  7 clearing corporation from 19 -- I guess it was  8 '83 or '4 through 1987. I -- and was on the  9 board of the clearing corporation.  10 My brother was a board member of the  11 Depository Trust Company.  12 The -- and those -- that organization  13 cleared primarily equities. It then grew -- it  14 eventually cleared government bonds and -- and  15 other bonds and also international securities.  16 I was chairman of the International  17 Clearing Corporation, which is part of that  18 organization as well. And that basically, you  19 know, allowed the industry to grow to the level  20 that it grew until presently, because it was a  21 seamless type of a transaction.  22 And to where it is now, settlement  23 really basically happens in one day, rather than  24 seven days. Although, it's still a three-day  25 settlement, but you have to sort of match the</p>	29	<p>1 were handled.  2 Primarily it was -- it could have  3 been -- it could be held as just custody at DTC  4 as well, or a lot of firms held it with a  5 custodian bank that was a primary dealer in  6 securities.  7 We had billions of dollars worth of  8 treasuries in custody at Morgan Stanley,  9 JPMorgan, Bank of New York, Bear Stearns. We  10 typically, you know, up until pretty much the  11 end of my firm --  12 Q. Is this on the market making business side?  13 A. No. In the -- in the investment  14 advisory firm.  15 We typically had, you know, upwards of  16 four billion dollars worth of treasury bills  17 in -- in custody at those firms. Where -- all  18 of our equities were held at DTC.  19 Q. So let's -- let me take a step back and  20 discuss the money management, slash, investment  21 advisory side of the business.  22 So who are -- who are your investors  23 generally in that side of the business?  24 A. The investment -- the management?  25 Q. Yes.</p>



30	<p>1 A. Well, primarily hedge funds and banks.  2 The lines were blurred between the hedge funds  3 and the banks, because a lot of the hedge funds  4 cleared and settled through banks or owned by  5 banks and so on. So -- but primarily the bulk  6 of the business was hedge funds and -- and  7 banks.  8 Q. So, if I understand this correctly, the  9 hedge funds and the banks would provide you with  10 funds to invest on their behalf?  11 MR. REGAN: Objection.  12 THE WITNESS: Yes.  13 MR. REGAN: You can answer.  14 THE WITNESS: Yes.  15 BY MR. BLEICHMAR:  16 Q. And -- and how did you invest that money?  17 A. Well, we -- let's talk pre --  18 Q. Let me take it back.  19 How did -- what did you tell these  20 investors of how you invested that money?  21 MR. REGAN: Objection.  22 You can answer.  23 THE WITNESS: Okay. Well, the investment  24 strategy that we used for all of the hedge  25 funds, which were in banks, which are the same,</p>	32	<p>1 let's say that it was all basically deemed to be  2 investment management, handled by myself, was a  3 completely legitimate business, where we  4 actually were going out and purchasing  5 securities involved and holding the securities.  6 And those were completely legitimate  7 transactions.  8 In the late '80s I got myself into a bit  9 of difficulty with a number of large investors,  10 primarily four investors that had been investors  11 of mine for many, many years, who were doing a  12 form of hedging with me to -- basically the goal  13 was to obtain long-term gains on security  14 positions that they held.  15 At the -- during the crash of '87 -- and  16 let me just back up.  17 The -- those -- those transactions  18 involved buying a portfolio of securities and  19 then hedging them with options, but not with a  20 model, as I was doing with the others. It's a  21 distinct situation.  22 The idea would be you would hold  23 those -- they would hold those securities for at  24 that time a one-year period, which was the  25 holding period for long-term gains, and they</p>
31	<p>1 as well as individual clients that we had, was  2 basically a form of option arbitrage, where we  3 developed a model where we bought originally 15  4 securities. That then grew into 50 securities  5 in the S&amp;P 500.  6 And we hedged those transactions using S&amp;P  7 100 index options, which had a correlation to  8 that -- to those securities.  9 That was -- that started in the -- in the  10 '80s. And that was a -- a business that we did  11 for everyone, including hedge funds and so on.  12 BY MR. BLEICHMAR:  13 Q. And is that --  14 A. A hedge --  15 Q. Is that business generally referred to  16 as -- or that strategy referred to as the  17 split-strike conversion strategy?  18 A. Yes. Right.  19 Q. I didn't mean to interrupt. Go ahead.  20 A. No. The -- the hedge fund money  21 basically came in in the '90s. And up until the  22 '90s the business was -- that I was doing for  23 the -- for everybody in the investment advisory  24 or investment management side, even though I  25 wasn't registered as an investment advisor, but</p>	33	<p>1 would hedge those securities by selling -- doing  2 what's known as covered rights options or buy  3 inputs against those securities.  4 At that same time, starting in 1980, I  5 was doing a large arbitrage business in  6 convertible securities with European banks,  7 primarily a bank called Banque Privee, de  8 Gestion Francais, which is a Paris bank, private  9 investment bank, which -- who was introduced to  10 me by a Swiss banker that I knew.  11 And primarily there was a French client  12 by the name of Albert Igoin, I-g-o-i-n, who was  13 an ex-banker, who was primarily a private  14 investor.  15 And they were -- they had approached me  16 in 1980 to do convertible security arbitrage for  17 them, which was the buying of convertible  18 securities and selling simultaneously the equity  19 side of the business, which was something that  20 we had done for many, many years and had  21 developed a business that was --  22 We were one of the largest convertible  23 securities on Wall Street. Traded convertible  24 securities as a market maker.  25 This -- this business went on from 1980</p>

34	<p>1 into the '90s, and simultaneous to me doing that 2 business.</p> <p>3 And they -- that -- that bank was also 4 the counterparty on the equity sides of the 5 business that I was doing for the four large 6 investors.</p> <p>7 It's relevant -- and hopefully it'll 8 become a little bit clearer a little bit as I 9 get into the story. The -- so -- and it was a 10 good fit for everybody.</p> <p>11 There was also a -- I was approached 12 at -- at the same time by this bank and some 13 other French banks that were interested in 14 utilizing a strategy to hedge their positions in 15 the French franc.</p> <p>16 In those days French citizens could not 17 hedge currencies. There were currency controls 18 in -- that existed in 1980, when Mitterrand came 19 into France. Things were in a turmoil. He 20 started nationalizing the bank. He nationalized 21 Rothchild and some other banks.</p> <p>22 And everybody was worried about them 23 becoming -- going communist. So there was a 24 tremendous move to try and hedge the currency, 25 but you couldn't do that.</p>	36	<p>1 They would buy -- they would take those 2 million dollars and pay for the million dollars 3 worth of securities we had. In this way they 4 owned dollars.</p> <p>5 Now, of course, that put them at risk of 6 the U.S. equity market. So they approached me 7 with -- because we were known as a big hedging 8 firm at that time, they said, can you hedge our 9 market risks?</p> <p>10 We don't -- we're not looking to make 11 any money in the market, quite frankly. We 12 won't object to it, but we primarily are willing 13 to -- to make our money from the currency, from 14 being long dollars and out of francs, as long as 15 we didn't lose money in the equity side.</p> <p>16 So I went about -- and this transaction 17 was simple -- according to them was -- was prior 18 to this handled by Goldman Sachs and other large 19 firms, but they were charging them large -- 20 large fees to do this.</p> <p>21 At that stage our reputation was a low 22 cost execution provider, because of the 23 technology that we already developed, and 24 because of the large amounts of order flow we 25 had.</p>
35	<p>1 If you were a French citizen, you 2 weren't even allowed to take francs out of the 3 country. When a French citizen traveled, they 4 could only take enough money to basically not 5 even buy hotel rooms.</p> <p>6 So they needed friends to give them 7 money to pay for these things. It was, you 8 know, absurd, but that's the way it was.</p> <p>9 Anyhow, the banks approached me with a 10 strategy that allowed them to hedge the 11 currency -- the French currency by the following 12 procedure.</p> <p>13 They were allowed to sell French francs 14 and buy dollars, providing the dollars that they 15 were purchasing were used to pay for U.S. 16 equities, which, obviously, was a requirement.</p> <p>17 If you -- if we bought stock for a 18 client, we didn't want to be paid in francs. We 19 wanted to be paid in dollars. So they would -- 20 they would take their French francs and sell 21 them.</p> <p>22 And if they needed a million dollars, 23 they would sell a million of those French 24 francs. The bank would convert it to a million 25 dollars in -- in dollars.</p>	37	<p>1 So we negotiated with them that we would 2 do the hedging transaction, handle the whole 3 thing for them at a lower -- lower rate than 4 they were charged.</p> <p>5 This made a natural fit for these large 6 clients that I was trading for, who were 7 interested in buying a large portfolio of U.S. 8 equities.</p> <p>9 So I was able to, you know, cross the 10 transactions in the U.S. equities with the 11 equities that the bank was doing, hedge their 12 transaction with options and so on.</p> <p>13 Okay. I don't know if you're all 14 following this, because the SEC had a great deal 15 of difficulty --</p> <p>16 Q. And at that point --</p> <p>17 A. -- with this.</p> <p>18 Q. Let me -- let me try to break that up a 19 little bit in pieces.</p> <p>20 A. Okay.</p> <p>21 Q. So, in other words, the French banks send 22 you French francs to purchase equities --</p> <p>23 A. No.</p> <p>24 Q. -- correct?</p> <p>25 A. That's done by the -- they --</p>

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38	<p>1 Q. They sent you dollars?</p> <p>2 A. They sent me dollars.</p> <p>3 Q. You purchased equities for them; correct?</p> <p>4 A. Correct.</p> <p>5 Q. And you hedged it using options to minimize</p> <p>6 the market risk; correct?</p> <p>7 A. Right.</p> <p>8 And those equities were held at -- at</p> <p>9 either DTC or, you know, other places.</p> <p>10 Q. Did -- did you provide the banks with</p> <p>11 statements of their equity positions?</p> <p>12 A. Yes. They were no different than any</p> <p>13 other client of mine. We sent out confirmations</p> <p>14 and monthly statements.</p> <p>15 Q. So they received monthly statements on BMIS</p> <p>16 letterhead?</p> <p>17 A. Correct.</p> <p>18 Q. And at one point you said that this for</p> <p>19 awhile was a legitimate business; correct?</p> <p>20 A. Correct.</p> <p>21 Q. And then you said you got a little into</p> <p>22 trouble?</p> <p>23 A. Right.</p> <p>24 Q. How did you get into trouble?</p> <p>25 A. Okay. When the market crashed in '80 --</p>	40	<p>1 A. Because they were the counterparties on</p> <p>2 the options, hedged their portfolios.</p> <p>3 Q. Picower or Shapiro, who you --</p> <p>4 A. So you basically had Picower or</p> <p>5 Shapiro -- you had Picower and Shapiro, who</p> <p>6 purchased the options. The options were sold by</p> <p>7 the French banks -- you know, the French bank, I</p> <p>8 should say.</p> <p>9 And the understanding was that these</p> <p>10 options were going -- they were long-term in</p> <p>11 nature, commonly referred to as leaps. But the</p> <p>12 understanding was that these options were to be</p> <p>13 held for at least a year. And that was</p> <p>14 primarily because the equities had to be held</p> <p>15 for a year from the large clients.</p> <p>16 The banks needed to have their positions</p> <p>17 hedged as well. So it was an understanding</p> <p>18 between the parties that these transactions were</p> <p>19 long-term in nature.</p> <p>20 The -- now, in those days</p> <p>21 over-the-counter options were basically endorsed</p> <p>22 by the broker putting them together, which meant</p> <p>23 that he was standing behind the options.</p> <p>24 Q. So you were standing behind the options?</p> <p>25 A. Yeah. I mean, if they defaulted. As</p>
39	<p>1 well, part of the arrangement that I had with</p> <p>2 these four clients was that their securities --</p> <p>3 Q. Which four clients?</p> <p>4 A. Jeffrey Picower, Carl Shapiro and his</p> <p>5 family. Picower had also a number of -- of</p> <p>6 accounts, you know, large accounts.</p> <p>7 Norman Levy, who was a large real estate</p> <p>8 investor. Stanley Chase, who was a California</p> <p>9 hedge fund -- it was really a limited</p> <p>10 partnership. He never registered as a hedge</p> <p>11 fund.</p> <p>12 Those are the four clients. There were</p> <p>13 a few others. The --</p> <p>14 Q. You mentioned a Swiss guy?</p> <p>15 A. Yeah -- no. Oh, that was -- he just</p> <p>16 made the introductions, Albert Igoin.</p> <p>17 Q. I understand.</p> <p>18 A. He was in the pipeline.</p> <p>19 Q. I understand.</p> <p>20 A. The arrangement was that they would buy</p> <p>21 this portfolio of securities, and then we would</p> <p>22 sell options against it.</p> <p>23 Now, the -- understand that these</p> <p>24 options were primarily over-the-counter options.</p> <p>25 Q. How is this related to the French banks?</p>	41	<p>1 opposed to now, the clearing corporation</p> <p>2 options -- the clearing corporation now handles</p> <p>3 those transactions.</p> <p>4 But all of the derivative products that</p> <p>5 you see that got the industry -- the country</p> <p>6 into trouble, all of these CDOs and CDSs and so</p> <p>7 on, those are also over-the-counter options.</p> <p>8 So a very, very small percentage of</p> <p>9 option business, both equity options and all of</p> <p>10 these derivatives, are actually done on</p> <p>11 exchanges.</p> <p>12 They are primarily all done over the</p> <p>13 counter, where the various counterparties keep</p> <p>14 changing and so on and so forth. And it's a</p> <p>15 whole myriad of cyberspace type of situations.</p> <p>16 Q. So let me try to break this down, see if I</p> <p>17 understand it.</p> <p>18 The French bank or banks sent you dollars</p> <p>19 and purchased equities; correct?</p> <p>20 A. Correct.</p> <p>21 Q. And then also entered into option</p> <p>22 transactions to hedge their market exposure?</p> <p>23 A. Right.</p> <p>24 Q. And the French banks were on one side of</p> <p>25 the option transaction, and Mr. Shapiro, Mr. Levy,</p>

42	<p>1 Stanley Chase and Picower were on the other side?</p> <p>2 A. Yes, but --</p> <p>3 Q. And you were in the middle?</p> <p>4 A. But I was in the middle, as -- because</p> <p>5 those transactions were basically handled as</p> <p>6 principal transactions, which is typically the</p> <p>7 way the market makers trade.</p> <p>8 Q. So when did -- where did it go wrong?</p> <p>9 A. Okay. When the market crashed in '87,</p> <p>10 these four clients, primarily Picower and</p> <p>11 Shapiro, were concerned that the market was</p> <p>12 going to continue to go into a free-fall, and</p> <p>13 they were going to lose the advantage of their</p> <p>14 long-term gains that they had been holding.</p> <p>15 Now, of course, from 1980 until 1987 the</p> <p>16 market -- when I -- when -- I devised the</p> <p>17 strategy for them in 1980. The strategy was</p> <p>18 dependent upon the market going up, because you</p> <p>19 can't get long-term gains unless the market goes</p> <p>20 up.</p> <p>21 Prior to this they were using Silver</p> <p>22 Straddles and all of these different types of</p> <p>23 Mickey Mouse type of hedging strategies, tax</p> <p>24 shelters, which the government was disallowing</p> <p>25 anyhow.</p>	44	<p>1 they, as typical retail clients, even though</p> <p>2 they were wealthy retail clients, would do is</p> <p>3 they decided that they did not want to lose</p> <p>4 these gains, which they always objected to</p> <p>5 selling over the years, even though their --</p> <p>6 their holding period was -- was long past, but</p> <p>7 they were --</p> <p>8 Not only now did they want the long-term</p> <p>9 gains, they wanted to defer paying the taxes on</p> <p>10 the long-term gains as well, which is, you know,</p> <p>11 the -- not that hard to understand, if you</p> <p>12 knew -- if you did a client business.</p> <p>13 So this led to them basically saying,</p> <p>14 well, look, we've got to sell, because you can't</p> <p>15 guarantee the market is going to go down.</p> <p>16 I said, well, that's true. Now, you're</p> <p>17 hedging. You're not going to lose anything, but</p> <p>18 you will lose the long-term gain aspect of it.</p> <p>19 At that time also there was rumblings</p> <p>20 from the IRS about shelter -- about Straddle --</p> <p>21 Silver Straddles and long-term gains and hedging</p> <p>22 and all of this stuff that was going on.</p> <p>23 So they basically --</p> <p>24 Q. When you say there was rumors from the IRS</p> <p>25 that they would disallow the --</p>
43	<p>1 So I went to them at that time, and I</p> <p>2 said, look, the only way you're going to get</p> <p>3 long -- you're going to -- you really get</p> <p>4 sheltered income is by trying to develop</p> <p>5 long-term gains in the equity market.</p> <p>6 Their concern was, well, that means the</p> <p>7 market going up. And I said, look, well, that's</p> <p>8 for sure. I said, I can't guarantee that, but</p> <p>9 at that time I felt strongly about the market,</p> <p>10 because it just looked to me to be bottoming</p> <p>11 out.</p> <p>12 And I said, you know, you have nothing</p> <p>13 to lose by trying it. So they gave me the go</p> <p>14 ahead, and we developed this.</p> <p>15 Well, by the time 1987 came we had</p> <p>16 huge -- billions of dollars worth of long-term</p> <p>17 gains.</p> <p>18 Q. And by, "we," who are you referring to?</p> <p>19 A. Meaning the clients, you know. All I</p> <p>20 was making was the commissions and markups on</p> <p>21 the transactions. I was not a party to the</p> <p>22 transactions.</p> <p>23 Q. And, "the clients," meaning Mr. Shapiro and</p> <p>24 Picower?</p> <p>25 A. Shapiro, Picower and Chase. The -- so</p>	45	<p>1 A. That they --</p> <p>2 Q. -- ability not --</p> <p>3 A. -- were changing the rules -- the</p> <p>4 Straddle rules on hedges, that basically said</p> <p>5 that, if, in fact, you are long one security and</p> <p>6 short a similar security, which was part of the</p> <p>7 strategy, they were going to disallow that,</p> <p>8 because there was no risk involved in that.</p> <p>9 So --</p> <p>10 Q. They were going to disallow the ability not</p> <p>11 to --</p> <p>12 A. The long-term gain.</p> <p>13 Q. The long-term gain. Correct.</p> <p>14 A. Right.</p> <p>15 The -- I was put in an awkward position,</p> <p>16 because I was being pressured by these clients</p> <p>17 to sell their long equity positions, take their</p> <p>18 profits.</p> <p>19 And they then said, but they -- I said,</p> <p>20 well, look, it's a problem for me, because I</p> <p>21 can't -- if I sell the equities, then I'm</p> <p>22 open -- you're open on the -- on the hedge side</p> <p>23 of the transaction, and you're at risk.</p> <p>24 Well, they said, well, the market is</p> <p>25 going to go down anyhow. So, therefore, they --</p>

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46	<p>1 the money that they would -- they were short,  2 the hedges they were short, were going to be a  3 profit as well.  4 I said, well, that's not -- that's not a  5 guarantee.  6 So the -- there was a -- there was a --  7 a lot of negotiation between me and the four  8 clients, because I felt obligations to the  9 French clients, who were on the other side of  10 the hedges. And --  11 Q. And who were the French clients?  12 A. Banque Privee.  13 Q. Banque Privee.  14 A. And Albert Igoin.  15 And I said, look, this has, you know,  16 put me in an awkward position. The  17 understanding, which we all agreed to, was that  18 these trades were going to be held for -- you  19 know, until they were ready to unwind the  20 transaction on their side.  21 So I foolishly decided that I would step  22 in, and I would take their position on the short  23 side of the option, which meant that basically I  24 was now at risk for the -- for the market, you  25 know, going up, because I was now short the</p>	48	<p>1 for all of them becoming billionaires. And we  2 were -- you know, our families were close.  3 So they said to me, look, we will change  4 our trust agreements and our wills, so that you  5 will be held harmless.  6 Meaning now they couldn't -- they said,  7 look, you are in charge of investing for us  8 forever. And even after we die -- because by  9 now Picower -- not Picower, but Shapiro was, you  10 know, in his late 80s. Levy was the same.  11 I said, look, you know, I don't want to  12 have to deal with your children, you know, you  13 know, on a -- to say basically, your father told  14 me so.  15 So their lawyers put together -- they  16 changed their trust agreements, that basically  17 said that I was the only one that could invest.  18 I was not liable for any risk involved in this.  19 As a matter of fact, Levy's bank was the  20 trustee of his -- and the bank said, look, you  21 know, we want to be the -- we want to be the  22 executor. We want to be responsible for  23 investing, not Madoff.  24 And he said, no, no. So he -- I then  25 became the executor of his estate and all of his</p>
47	<p>1 options that they were short and the -- and I  2 didn't have the equities to cover that, which --  3 because they had sold -- I had sold that for  4 them.  5 So I said, look, I can't do this,  6 because I think the market is going to go up  7 eventually, and this is going to be a disaster.  8 So they said, okay. Look, we'll hold  9 you harmless for the option loss, because we  10 think the market is going to go down.  11 So I said, well, how are you going to do  12 that?  13 So they said, well, we'll -- we will  14 change our trust in -- you have to understand,  15 these people are like family to me. So it  16 was -- it was a -- a very close relationship.  17 It wasn't just a business relationship.  18 Q. In what way were they like family?  19 A. Well, they were sort of like -- Shapiro  20 was sort of like a father figure to me. So was  21 Norman Levy.  22 Picower, who really was my age, was not,  23 but I was the executor of his estate and all of  24 those things.  25 And I was basically the one responsible</p>	49	<p>1 children's trusts and so on and so forth.  2 And the -- there were other arrangements  3 made between their foundations and me, where I  4 would invest money for their foundation  5 accounts, which I was investing. And --  6 Q. So what -- so what went wrong?  7 A. Well, the market, as I had feared, went  8 up. I theoretically was covered by them, even  9 though it was sort of a bizarre arrangement, to  10 be -- to be quite honest with -- but --  11 And that was a major, major blunder on  12 my part, which is still hard for me to  13 understand. And hard for my -- probably wife to  14 understand and my sons.  15 Although, quite frankly, they weren't  16 even aware of this. My sons are still not aware  17 of it. My wife just became aware of it, you  18 know, recently.  19 The -- I just foolishly did this,  20 because I didn't want to ruin the relationship  21 with the -- with the banks.  22 I never thought the market would run the  23 way it did. You know, I thought it would  24 recover, but not at the levels that it did.  25 And, unfortunately, Jeffrey Picower, who</p>

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50	<p>1 was a large investor with Goldman Sachs, started 2 to tell me that he was losing money at Goldman 3 Sachs, which I certainly knew was likely, 4 because he was a real, you know, speculator, to 5 begin with. 6 He was a leverage type of a player. He 7 had invested -- he was one of Ivan Boesky's 8 original investors and -- and sort of got burnt 9 with Ivan Boesky. 10 He was an investor in long-term capital 11 at Goldman, that Goldman arranged for him, which 12 was the hedge fund that went bust in '98. 13 Q. So Picower lost money? 14 A. Yeah. And he lost a huge amount of 15 money, he told me, in the bond market in the 16 '90s with Goldman. They had a real fiasco for 17 their clients. 18 And I said to him, what's -- what's 19 going to happen? I said, you know, you were 20 the -- you're getting wiped out. 21 And he was the one that made more money 22 than anybody else with me. More than -- you 23 know, Shapiro had maybe made like a billion 24 dollars, and Picower had made billions of 25 dollars.</p>	52	<p>1 a quick restroom break? 2 MR. BLEICHMAR: Sure. We'll finish this 3 line of questioning, and we'll take a break in 4 five minutes. 5 MR. REGAN: Sure. 6 THE WITNESS: I'm almost finished with 7 this. 8 MR. REGAN: No. That's fine. 9 THE WITNESS: So the -- I started to get 10 nervous, and this started in the -- this 11 basically came to a head in the -- in the '90s. 12 And at that time I was being pressed by a 13 number of hedge funds to invest money in this 14 model developed -- the model site trading, 15 split-strike conversion, that we were dealing 16 with. 17 And I looked at -- I said to myself, look, 18 if I'm never going -- if I'm -- I'm going to -- 19 I'm now in a hole, because I was now out, you 20 know, a couple of billion dollars from -- 21 BY MR. BLEICHMAR: 22 Q. From Picower? 23 A. -- from Picower and these other people. 24 And the only way I'm going to make this money 25 up, if, in fact, Goldman does not make this</p>
51	<p>1 So he assured me, don't worry. Goldman 2 is going to take care of me. I am -- you know, 3 they're going to give me special treatment. I 4 will deal with -- you know, they're going to 5 give me all of their deals. 6 And Goldman -- I was friendly with 7 partners at Goldman. So I knew that they had 8 the capability of doing that. As a little 9 thing, news event, was uncovered, you know, I 10 guess a few years ago between Goldman and 11 Gaddafi's family in a similar situation, where 12 Goldman had lost a lot of money on a hedge 13 transaction for them, and then promised Gaddafi 14 that they would structure some special deals for 15 them, which somehow -- 16 You know, nothing really came of this 17 whole thing. They were threatening lawsuits, 18 but at that time Gaddafi was -- had bigger 19 problems to worry about than Goldman Sachs. 20 Q. So Picower lost money with Goldman? 21 A. Picower lost money, or at least he let 22 me believe that. 23 Q. Uh-huh. 24 A. And I had no reason to not. 25 MR. REGAN: When convenient, could we take</p>	53	<p>1 money up to them from favorable treatment or the 2 market, getting lucky, whatever, I've got to 3 start taking on some more assets and build my 4 investment management business. 5 And I had all of these funds clambering, 6 primarily Fairfield and Kingate, at the time and 7 Sonya Kohn, you know, and so on, to take in 8 money to do this model trade that the boy genius 9 on Wall Street, named Bernie Madoff, was 10 basically -- had developed to do his trading, 11 and was successfully doing it for a number of 12 clients. 13 Aside from the -- Shapiro and Picower 14 and so on. I was also doing that type of 15 trading for -- for the banks, the European bank, 16 Banque Privee. 17 So I decided to take this money in. 18 Now, one of the caveats -- or one of the 19 conditions of me taking the monies in was that 20 it was going to be long-term money. 21 And that was for two reasons. Number 22 one, the hedge fund business was a business that 23 I really disliked, because it was known as hot 24 money business. 25 In other words, the hedge funds, as long</p>

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54	<p>1 as you were making money for them, loved you and  2 would stay with you and so on, but at the first  3 sign of fire, you know, and trouble, they would  4 disappear and take their money back, which, of  5 course, would always come at an inopportune  6 moment.  7 The -- so I basically said to these  8 hedge funds, look, you know, I don't want -- I  9 don't want to build up a business with hedge  10 funds and then find it disappearing, you know,  11 for some reason one day overnight.  12 And they, in turn, said, well, look, if  13 you want long-term money from us, that's a  14 different kind of client than we typically have,  15 and we have to commit to those clients that  16 you're going to invest it.  17 So, ironically, they were more worried  18 about me not investing -- continuing to invest  19 the money than I was worried about them, you  20 know, running for the exits.  21 So there was a -- an understanding that  22 I would -- even though there was no guarantee on  23 either side, that the understanding was that I  24 was going to invest this money for them, and  25 that they were going to get the type of client</p>	56	<p>1 the court have a hard time believing that, but  2 to this day they've never been able to put forth  3 any evidence that contradicts what I had said.  4 Q. And how did it become illegitimate?  5 A. It became a problem, because I had --  6 well, let me just give you a preamble a little  7 bit. I'll try and make it short.  8 Market makers, like myself, continuously  9 trade sometimes on the short side of the market.  10 In other words, where we're actually obligated  11 by the SEC rules to maintain a continuous  12 market, which means once we put out a quote it  13 has to be a two-sided quote, regardless of  14 whether or not we actually own a security.  15 So if I happen to be -- if IBM has been  16 constantly moving up, and I don't have any stock  17 in inventory, I am still required to offer stock  18 out to my clients, meaning from the short side  19 of the market.  20 So most market makers will -- are  21 continuously trading on both sides of the  22 market. Long, meaning they own securities, have  23 an inventory, and short, meaning the -- they're  24 selling stock they don't own, with the  25 expectation of buying it back at a lower price,</p>
55	<p>1 that was going to be a long-term investor.  2 And they disclosed -- disclosed the  3 client -- the type of client that they had. And  4 I met some of those clients, and those clients  5 were anywhere from Bernard Arnault, from Louis  6 Vuitton, to L'Oreal, the -- the Bettencourt  7 woman from L'Oreal.  8 Q. Uh-huh.  9 A. To Swiss bankers and so on and so forth.  10 Q. So that was the legitimate strategy for  11 this split-strike conversion strategy; right?  12 A. Right.  13 MR. BLEICHMAR: Why don't we take a short  14 break and then pick up from here.  15 MR. REGAN: Yeah.  16 MR. BLEICHMAR: Let's go off the record.  17 (RECESS FROM 8:53 A.M. TO 9:01 A.M.)  18 MR. BLEICHMAR: Back on the record.  19 BY MR. BLEICHMAR:  20 Q. What -- when did the money management  21 business become illegitimate?  22 A. Did it become or illegitimate?  23 Q. Illegitimate.  24 A. It started in '92, as I've testified.  25 Although, for some reason, the government and</p>	57	<p>1 hopefully, or possibly at a higher price at a  2 loss. It is very common, and there is -- as I  3 say, it's part of doing business.  4 So the idea of -- and, not only that, I  5 mean if you decided you didn't like the market,  6 you could actually go short and just hope the  7 market is going to go down.  8 But most market makers always have a  9 short condition as a hedge against their long  10 inventory, even if it's a different type of  11 security.  12 And I, of course, because I was -- I had  13 a business of doing arbitrage since the very  14 beginning, where I was long bonds and short  15 stock and converted them. It was a natural  16 thing for me to do.  17 So I was in a situation where after I  18 had taken on some money for these funds in the  19 early '90s, that the market went into sort of  20 a -- we -- the market was -- we were in a  21 recession.  22 The Gulf War, you know, occurred. The  23 market was just doing nothing. And in order for  24 this -- my strategy to work, we basically needed  25 primarily an upmarket. Not necessarily</p>

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<p style="text-align: right;">58</p> <p>1 continuous upmarket, but a market that had a lot 2 of spikes in it, where it would give you the 3 opportunity to trade from the long side, and 4 then also be able to shorten the option side and 5 so on. 6 The -- the strategy basically was that 7 when I was not in the market I would put the 8 money, the capital, that I had to invest from 9 these funds, or all clients, in treasury bills. 10 That was part of the stated strategy, 11 which was all laid out in documents of what was 12 something that we called trading authorization 13 and a trading directive. 14 So I was in a situation where I was 15 being pressured by the funds to put this money 16 to work, because when I -- when they -- 17 typically they would send me in money, it would 18 be a million dollars, five million dollars. 19 The money would immediately go into 20 treasuries, and it would stay there. And it 21 would earn, in those days, a couple of percent 22 in treasuries, as opposed to maybe 12 or 13 23 percent, which was what the expectation was and 24 the strategy. 25 So -- but the money would sit there</p>	<p style="text-align: right;">60</p> <p>1 was violated and so on. 2 And I assumed that it was going to be a 3 temporary situation. So I realized, obviously, 4 I'm now, in reality, earning two percent on the 5 money and paying out in the sense of profits, 6 you know, 12 or 13 percent. So I have a net 7 loss of ten, 11 percent each transaction. 8 Q. Explain that to me again. 9 A. Well, the confirmation that they were 10 receiving -- 11 Q. So you weren't executing the transaction? 12 A. I wasn't executing the transaction 13 correctly. So the transaction is now a bogus 14 transaction. It's -- well, in their minds -- 15 you have to understand that they don't -- they 16 couldn't care less, nor could any other client, 17 whether I am actually long on the stock or not. 18 That's something that is hard for people 19 to understand, but, as I say, when you -- if you 20 go and you call Merrill Lynch and tell Merrill 21 Lynch, I want to buy Apple Computer, and Merrill 22 Lynch, either from their own inventory, if 23 they're a market maker, sells you Apple 24 Computer, they may not own Apple Computer. 25 You own Apple Computer. And you</p>
<p style="text-align: right;">59</p> <p>1 or -- being stored or parked, as they call it in 2 the industry, in treasury bills, waiting for an 3 opportunity to go into the market. 4 But since -- as the market sort of 5 refused to cooperate, they were sitting in -- in 6 treasuries. 7 And I started getting phone calls from 8 these guys, saying, look, you know, you've got 9 to start putting the money to work. You know, 10 we're not interested in just making, you know, 11 treasury bill interest. We don't need you for 12 that. 13 And, of course, their clients, who were 14 all very aggressive clients, are pushing them, 15 you know, to -- you know, what's going on? You 16 know, the first, you know, months' returns are 17 like two percent, you know. 18 So I made my second blunder, and I said, 19 okay. Look, I'll shorten the position goal, 20 which I was perfectly legal in doing. There was 21 nothing illegal about that. 22 If you looked at the confirmations that 23 I was supplying, it said that I am acting as 24 principal. I'm selling stock for them, and this 25 was not a -- not a problem. No SEC regulation</p>	<p style="text-align: right;">61</p> <p>1 can't -- couldn't care less what Merrill Lynch 2 makes or doesn't make on the Apple Computer. 3 Your contract is with Merrill Lynch, and you own 4 the Apple Computer. And this is the way 5 business is done. 6 As opposed to what most people think, 7 you know, that -- that isn't the way it's done. 8 They think that they actually own the stock, and 9 there's a physical certificate somewhere, and 10 that they are the owner. 11 And they are the owner, for all intents 12 and purposes, from a legal standpoint, but there 13 is no -- there's nothing on the other side of 14 the transaction, other than the good faith of 15 the broker, that says he is going to produce 16 that if you want to sell it, and you're going to 17 get the -- you're going to get the dividend, if 18 there's a dividend involved in it, and so on 19 with it. 20 That's coming from a short return, not 21 as academic to you. 22 Q. So you would produce -- 23 A. I would produce a confirmation, which 24 would be no different than if Merrill Lynch came 25 to me and wanted to buy Apple Computer, and I</p>



62	<p>1 shorted it, and they get this transaction.  2 Okay. And they --  3 Q. But you were only holding the treasuries at  4 that point?  5 A. And I had the treasuries. Okay.  6 Q. And so this is approximately 1992?  7 A. Right.  8 So they -- as far as they're concerned,  9 they're looking at a transaction, for all  10 intents and purposes, looks to them like a  11 totally normal transaction based upon the  12 parameters that we said that we would follow and  13 so on and so forth.  14 They're long stock. They're long puts.  15 They're short calls against the stock. For  16 example, they, themselves, as part of the  17 strategy are shorting options that they don't  18 own. You know, they're --  19 Q. What do you mean by that?  20 A. Well, the strategy is I buy them stock.  21 I buy them a put, and they sell a call, an index  22 call, short.  23 So they actually have a completely short  24 position in the call side of the transaction,  25 the index call. The same as I have a short side</p>	64	<p>1 Q. That's your contract with the hedge funds?  2 A. That's my contract with the hedge funds.  3 And their -- and their contract -- right. Their  4 contract with me.  5 So, you know, they -- they have the same  6 short position as I have, except in a different  7 instrument, you know, and it's perfectly legal.  8 Q. But, on the backside, you were not  9 purchasing this -- the equity --  10 A. I was not purchasing the equity, which,  11 of course, is a major issue, because there is --  12 as the market goes up, they're losing money on  13 the short side.  14 They're also losing money on the put  15 that they're long, but they're not making --  16 well, on paper they're making the gain on the  17 long side, the inventory, which, of course, I'm  18 short to them, and they don't own it.  19 So, again, there's nothing wrong with  20 any of this transaction as long as I'm good for  21 the difference.  22 Q. So let's talk about these investors. You  23 mentioned Fairfield and Kingate.  24 A. Uh-huh.  25 Q. Are these also commonly referred to as</p>
63	<p>1 position in the long side.  2 Now, they're -- they're exposed on  3 that -- that call that they're short, the same  4 way that I'm short on the stock. The only  5 difference is that they own the stock, which is  6 not convertible into the option, but  7 theoretically would move up at the same rate  8 that the call moves up.  9 Q. Uh-huh.  10 A. So they're hedged. They have a -- but  11 they actually -- they're selling stock that they  12 don't own, you know.  13 Q. But at some point these transactions  14 stopped occurring; correct?  15 You didn't execute the transactions?  16 A. No. This -- this is -- well, this is  17 when I was doing, let's say, the illegitimate  18 one.  19 Q. Uh-huh.  20 A. Okay. I never stopped doing that. So  21 they were -- you know, I would just generate the  22 confirmation. I was short the stock. They were  23 short the call.  24 Again, I don't know if you're following  25 that, but they basically --</p>	65	<p>1 feeder funds?  2 A. Yes.  3 Q. Who were some of the other feeder funds?  4 A. Well, there was Fairfield, who had a  5 number of funds. Kingate, who had a number of  6 funds. Thema, which is a Swiss fund. There was  7 Tremont, which was a U.S. feeder fund, that  8 eventually was bought out by Oppenheimer.  9 There was eventually Optimal, which was  10 owned by Banco Santander, I guess.  11 Q. And how did Optimal compare, in terms of  12 size, with these other funds?  13 A. Well, they --  14 MR. REGAN: Objection. Objection, but you  15 can answer.  16 THE WITNESS: They started out, I guess,  17 smaller than -- Fairfield was the largest one at  18 that time, but, just so you can get a scope of  19 the size, I think Fairfield was only -- in '95  20 was only about 500 million dollars, as opposed  21 to, you know, six billion eventually.  22 BY MR. BLEICHMAR:  23 Q. And what was your recollection of Optimal  24 in 1995?  25 A. I don't recall. I don't recall.</p>

66	<p>1 Q. What was your understanding of who were the</p> <p>2 underlying investors in these funds, in these hedge</p> <p>3 funds or feeder funds?</p> <p>4 A. Well, okay. The understanding was that</p> <p>5 they were all sophisticated investors.</p> <p>6 Q. Now, what does that mean to you,</p> <p>7 "sophisticated investors"?</p> <p>8 A. Well, my investors were basically</p> <p>9 required to do -- well, they signed documents</p> <p>10 that basically said that they had a net worth</p> <p>11 of -- a minimum of -- I would say the smallest</p> <p>12 was a minimum net worth of 250 million dollars.</p> <p>13 Q. Million?</p> <p>14 A. Yeah. 250 million dollars -- I'm sorry.</p> <p>15 \$250,000. Numbers get a little confusing to me.</p> <p>16 \$250,000. And they had income of \$100,000. And</p> <p>17 the net worth was exclusive of homes, of real</p> <p>18 estate.</p> <p>19 The -- that was -- they basically deemed</p> <p>20 to be a sophisticated investor from NCC, you</p> <p>21 know, regulations and so on. They also signed</p> <p>22 documents that said that they understood that</p> <p>23 there was a risk --</p> <p>24 Q. Uh-huh.</p> <p>25 A. -- involved in the type of transaction</p>	68	<p>1 other than Tremont. And even they had -- they</p> <p>2 had sophisticated clients.</p> <p>3 And most of them were European. They</p> <p>4 were all European, you know, hedge funds. And</p> <p>5 the typical clients that they had --</p> <p>6 Q. And why were they typically European?</p> <p>7 A. Because most hedge funds, big hedge</p> <p>8 funds, were registered in tax savings. They</p> <p>9 were registered in the BVIs or Switzerland and</p> <p>10 so on for -- for tax purposes and for disclosure</p> <p>11 purposes.</p> <p>12 And that's basically what -- where hedge</p> <p>13 funds, since the beginning of time. They</p> <p>14 were -- so --</p> <p>15 And I was, you know, told that they were</p> <p>16 these types of investors, because they said that</p> <p>17 was the only kind of investor that they could</p> <p>18 get to commit to a long-term -- you know, to a</p> <p>19 long-term type of investment.</p> <p>20 And that made sense also, because they</p> <p>21 said, look, these people are going to have to</p> <p>22 liquidate other investments that they have, and</p> <p>23 they don't want to liquidate these other</p> <p>24 investments and then come in to you, and then</p> <p>25 next month you're going to --</p>
67	<p>1 that they were doing, and that the gains were</p> <p>2 going to be basically short-term trading gains,</p> <p>3 which inherently had a risk involved in it.</p> <p>4 When the feeder funds came to me, I was</p> <p>5 basically looking at them as typical hedge fund</p> <p>6 type of investor, which all had net worths of --</p> <p>7 in the, you know, millions of dollars.</p> <p>8 Q. Meaning the underlying investors?</p> <p>9 A. The underlying investors.</p> <p>10 Q. So your understanding was that the</p> <p>11 underlying investors in the feeder funds were -- had</p> <p>12 a net worth in the millions?</p> <p>13 A. Yeah. I mean, now, typically the feeder</p> <p>14 funds had a smaller type of investors than the</p> <p>15 regular funds, regular hedge funds, but they</p> <p>16 weren't -- none of them basically were -- all</p> <p>17 the feeder funds were -- were basically --</p> <p>18 I was of the opinion, based upon the</p> <p>19 conversations I had with them, that they were</p> <p>20 not soliciting smaller clients. That these were</p> <p>21 all sophisticated clients of, you know,</p> <p>22 substantial net worths in the millions.</p> <p>23 And typically these -- that was the kind</p> <p>24 of investor that invested with these funds.</p> <p>25 These were not domestic, for the most part,</p>	69	<p>1 Q. Right.</p> <p>2 A. -- say, you know, game over. So it was</p> <p>3 understood. And it was a sophisticated type of</p> <p>4 a trade. This was a -- you know, not your</p> <p>5 typical type of hedge fund investment, where</p> <p>6 they would just buy a portfolio of securities.</p> <p>7 It was a hedge transaction. The appeal</p> <p>8 of this strategy was that you could do large --</p> <p>9 commit large amounts of money in a hedge</p> <p>10 transaction.</p> <p>11 Your returns were going to be lower than</p> <p>12 you would make in just a straight market,</p> <p>13 long-only strategy, but you -- you had -- the</p> <p>14 risk was hedged, which would enable them to</p> <p>15 commit more money than they normally would to</p> <p>16 just a risk type of a strategy. So this was</p> <p>17 understood.</p> <p>18 Q. Let's turn to -- to Optimal. When did</p> <p>19 Optimal begin investing with BMIS?</p> <p>20 A. I -- I really do not remember.</p> <p>21 Q. Approximately?</p> <p>22 A. I would assume in the late '90s. I'm</p> <p>23 guessing, though.</p> <p>24 Q. And who was the -- your original contact</p> <p>25 with Optimal?</p>

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70	<p>1 A. Manuel Echeverria. What --</p> <p>2 Q. Manuel Echeverria?</p> <p>3 A. Manuel. Manuel.</p> <p>4 Q. You remember him as Manuel?</p> <p>5 A. Yeah, Manuel, I knew him as.</p> <p>6 Q. And how did you meet Manuel?</p> <p>7 A. Well, he was introduced to me, I</p> <p>8 believe -- I'm not sure if he was introduced by</p> <p>9 Sonya Kohn or not. I don't know. You know, I'm</p> <p>10 sort of blurry.</p> <p>11 The hedge fund industry is a very</p> <p>12 incestuous industry, to say the least. So, you</p> <p>13 know, it's -- who made the introductions was</p> <p>14 always sort of totally unclear to me. You know,</p> <p>15 certainly, you know, in hindsight, going back,</p> <p>16 now I remember it.</p> <p>17 Q. And what was your understanding of Manuel's</p> <p>18 role at Optimal?</p> <p>19 A. He was a typical, you know, manager,</p> <p>20 which basically meant that they were -- they</p> <p>21 were marketing people.</p> <p>22 I mean, the breed of hedge funds that,</p> <p>23 you know, has developed -- and it was the same</p> <p>24 with all of my hedge funds, as clients were not</p> <p>25 the original type of hedge funds, like managed</p>	72	<p>1 sense or not, but --</p> <p>2 Q. What do you -- what do you mean by due</p> <p>3 diligence?</p> <p>4 A. Well, due diligence could be anywhere</p> <p>5 from making the decision as to the -- does the</p> <p>6 people that they're going to allocate the money</p> <p>7 to, does he have a good track record, and, you</p> <p>8 know -- or does the strategy that he's using</p> <p>9 make sense.</p> <p>10 So if -- if you're looking at a -- if</p> <p>11 you're looking at someone who is, let's say,</p> <p>12 just a long-only manager, like a Paul Tudor</p> <p>13 Jones, for example, or Louis Bacon, you know,</p> <p>14 those are just names, big names in the industry,</p> <p>15 who -- whose ability is to their macro</p> <p>16 investors, or they're -- they're making calls on</p> <p>17 the market or on individual securities.</p> <p>18 What you're doing is looking at their</p> <p>19 reputation. You're looking at their track</p> <p>20 record, as to whether or not -- how they</p> <p>21 perform.</p> <p>22 If you're doing a -- an arbitrage type</p> <p>23 of strategy, which basically was what we were</p> <p>24 doing, or a hedge type of strategy, then you're</p> <p>25 supposed to be qualified in understanding the</p>
71	<p>1 by Julian Robertson, Paul Tudor Jones, Michael</p> <p>2 Steinhardt and so on, where they were making</p> <p>3 decisions of investments. The -- particularly</p> <p>4 the feeder funds, and even some of the -- the</p> <p>5 larger funds.</p> <p>6 And Fairfield, Kingate, Optimal, they</p> <p>7 may have been deemed feeder funds, but they were</p> <p>8 so large they really -- no one really would --</p> <p>9 looked at them as feeder funds. They would just</p> <p>10 basically be, you know, looked at as being a</p> <p>11 hedge fund.</p> <p>12 They -- the managers of these funds make</p> <p>13 no decisions of investments, other than which</p> <p>14 sub-managers to invest the money for them.</p> <p>15 They -- most of them have no ability to</p> <p>16 determine whether the market is -- is cheap or</p> <p>17 not cheap or whether the -- or whether they</p> <p>18 should be buying IBM or General Motors.</p> <p>19 They're basically marketing people and</p> <p>20 salespeople, and they should be people with a</p> <p>21 sophisticated-enough background to understand</p> <p>22 the strategy.</p> <p>23 I mean, that's what clients pay them</p> <p>24 for. They pay them for -- to do due diligence</p> <p>25 and to understand whether the strategy makes</p>	73	<p>1 strategy.</p> <p>2 Q. Did you believe that Mr. Echeverria</p> <p>3 understood the split-strike conversion strategy?</p> <p>4 MR. REGAN: Objection.</p> <p>5 You can answer.</p> <p>6 THE WITNESS: Yeah. I mean it, quite</p> <p>7 frankly, was not that complicated a strategy to</p> <p>8 understand, you know, at least --</p> <p>9 BY MR. BLEICHMAR:</p> <p>10 Q. Why do you say that?</p> <p>11 A. Well, it was -- it was, you know, a</p> <p>12 basic strategy of -- a covered rights strategy.</p> <p>13 Meaning you buy -- you buy a security, and then</p> <p>14 you sell an option against that security that's</p> <p>15 related to that security.</p> <p>16 The unique part about our strategy was,</p> <p>17 instead of buying a straight IBM and selling IBM</p> <p>18 stock, which is what we used to do many years</p> <p>19 ago, which is known as a covered right, once</p> <p>20 index options became, you know, on stream in the</p> <p>21 '80s, we would buy a portfolio of securities,</p> <p>22 meaning 15 securities, that had a correlation to</p> <p>23 the S&amp;P index, which monitors.</p> <p>24 So those securities are correlated</p> <p>25 within 95 percent. So as the equities move up</p>

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<p style="text-align: right;">74</p> <p>1 or down, the hedge moves up or down, and there's 2 always a difference in arbitrage spread between 3 those transactions. 4 So -- and the strategy that we used we 5 laid out. It was -- it was documented. It was 6 instructions of what -- of what these securities 7 entailed, what the correlation was, and it was 8 easy to monitor -- 9 Q. Right. 10 A. -- those strategies. So it was -- it -- 11 it did not take any rocket science to -- to 12 understand the strategy for -- certainly for a 13 manager, you know. 14 Q. So you mentioned that you met 15 Mr. Echeverria approximately in the mid '90s; 16 correct? 17 A. Uh-huh. 18 Q. And -- 19 MR. REGAN: Objection, but go ahead. 20 BY MR. BLEICHMAR: 21 Q. And over the years how many times or how 22 often would you have contact with Mr. Echeverria? 23 A. Well, it varied. There was always -- 24 there was the initial meeting or series of 25 meetings.</p>	<p style="text-align: right;">76</p> <p>1 pressed to find people that knew who I was, but 2 within the industry, both from the regulatory 3 side or from the industry side, we were 4 certainly well-known. 5 We were doing, by the time they came on 6 stream, ten percent of all of the equity 7 trading, as I said. So our market making 8 operation was highly regarded, and -- 9 Q. When you say, "by the time they came," 10 you're referring to -- 11 A. Echeverria. 12 Q. -- people at Optimal? 13 A. Yeah. So that would be a meeting. And, 14 you know, then another meeting would be with 15 possibly their due diligence team, which could 16 be one or two people. 17 Q. Who do you remember from their -- from 18 Optimal's due diligence team? 19 A. Well, I remember Jonathan Clark, was one 20 person. It was -- I will tell you that I was 21 never 100 percent sure of who I was meeting 22 with. 23 And this was because a lot of these 24 funds, they would try and bring up people that 25 were not supposed to attend the meetings. In</p>
<p style="text-align: right;">75</p> <p>1 Q. Do you remember those? 2 A. Yeah. I mean the original meeting would 3 be a -- an exploratory meeting, where the 4 manager or, you know, a group of people, you 5 know, that was in his organization, could be two 6 or three, would meet me. 7 We would sort of feel each other out, as 8 to whether or not, number one, I was -- thought 9 they -- they were the type of people that I 10 would want to do business with, that they had 11 the type of clients that I felt the strategy was 12 suitable for and that they basically understood 13 the strategy. 14 And that, you know, they had a 15 reputation of being, you know, legitimate. 16 Meaning they weren't representing necessarily 17 hot money or, you know, questionable money and 18 so on. 19 So there was sort of a -- everybody was 20 taking each other's temperature. Of course, you 21 know, I had at that stage a substantial 22 reputation in the industry. So they were -- 23 most of them knew me, knew of me. 24 Their clients certainly did not, because 25 outside of the industry itself you'd be hard</p>	<p style="text-align: right;">77</p> <p>1 other words -- 2 Q. What do you mean by that? 3 A. Well, I made it very clear that I was 4 not interested in entertaining a competitor. 5 All right. I was not interested in them 6 bringing up a -- someone who ran their 7 derivative desk or run their arbitrage desk or 8 equity trading, who was going to pick my brains 9 and try and mimic my strategy. 10 So I said, look, I don't mind meeting 11 with the manager. I don't mind meeting with a 12 legitimate due diligence person, who was not 13 deemed to be a competitor, but that was the 14 understanding. 15 And that privilege was sometimes 16 followed and sometimes abused. Sometimes people 17 would show up, who -- even though sometimes they 18 would give me business cards. Sometimes they 19 inconveniently didn't have a business card. 20 Sometimes I would find out that they 21 actually were running the derivative desk or 22 they were running their equity trading desk. 23 And sometimes they were their clients. 24 Sometimes it was a large investor that was 25 showing up and just sat there, listening to the</p>

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78	<p>1 presentation.</p> <p>2 Q. And why didn't you want an investor to meet</p> <p>3 with you?</p> <p>4 A. I wouldn't want an investor to meet with</p> <p>5 me.</p> <p>6 Q. And why not?</p> <p>7 A. Because it was understood that I was not</p> <p>8 doing retail business. I did not want</p> <p>9 investors -- basically it was -- there was --</p> <p>10 there was always an understanding that I was not</p> <p>11 to be marketed by these funds for the following</p> <p>12 reason.</p> <p>13 I -- my reputation in the industry was</p> <p>14 that of a wholesaler. My basic clients in the</p> <p>15 market making side of my business were other</p> <p>16 dealers, who would basically not be thrilled</p> <p>17 with me going after their retail clients or</p> <p>18 institutional clients.</p> <p>19 So Goldman Sachs or Merrill Lynch would</p> <p>20 not be interested in me, you know, taking their</p> <p>21 clients away from them, whom might be investing</p> <p>22 in their own hedge funds or their own</p> <p>23 investments, and putting money with me.</p> <p>24 So basically I said, okay. Everyone in</p> <p>25 the industry knows that -- that funds are fair</p>	80	<p>1 Q. Uh-huh.</p> <p>2 A. -- when they're not making the decision?</p> <p>3 You know, Madoff is the guy, and I can go</p> <p>4 directly to him.</p> <p>5 So there was always this understanding</p> <p>6 that they didn't want me to deal with their</p> <p>7 clients. I didn't want -- and I didn't want to</p> <p>8 deal with -- with their clients.</p> <p>9 And this grew up as being this</p> <p>10 mysterious, secretive type of an atmosphere. In</p> <p>11 other words -- which, of course, at --</p> <p>12 competitors in the hedge fund deal -- deal, that</p> <p>13 were not my competitors, and some of the media</p> <p>14 looked at this as don't ask, don't tell.</p> <p>15 There were articles written, Bernie is</p> <p>16 very secretive and so on and so forth, but,</p> <p>17 quite frankly, the hedge fund industry has</p> <p>18 always been cloaked in mystery.</p> <p>19 In other words, the original hedge funds</p> <p>20 would never consider talking to the clients</p> <p>21 of -- of a -- someone that's bringing them</p> <p>22 money.</p> <p>23 If you ever called up Michael Steinhardt</p> <p>24 and said, I want to have a meeting with you, or</p> <p>25 Paul Tudor Jones or anybody, and said, explain</p>
79	<p>1 game for everybody, but I never would solicit</p> <p>2 retail clients, whether they be John Q Public or</p> <p>3 whether they be institutional type of clients.</p> <p>4 And I didn't want my reputation as a</p> <p>5 wholesaler to be, you know, changed. So the --</p> <p>6 also, what I basically felt was that, look,</p> <p>7 these funds are making a fee in commission for</p> <p>8 their transactions for doing this.</p> <p>9 Q. Uh-huh.</p> <p>10 A. Therefore, it is their responsibility</p> <p>11 and their job to sell and explain the trading</p> <p>12 that's being done to their clients, not mine. I</p> <p>13 don't want their clients calling me up and</p> <p>14 asking me to -- to explain the strategy for</p> <p>15 them.</p> <p>16 I didn't have really retail clients at</p> <p>17 all, other than this handful of clients, which</p> <p>18 were not really retail.</p> <p>19 And, also, they didn't want their</p> <p>20 clients back-dooring them. In other words, the</p> <p>21 last thing they wanted was, you know, Bernard</p> <p>22 Arnault, just to use a name, saying, listen, why</p> <p>23 am I paying, you know, Fairfield, you know, you</p> <p>24 know, five percent, or whatever they're</p> <p>25 making --</p>	81	<p>1 to me what you're doing and tell me what you're</p> <p>2 investing in the market, they would say, you've</p> <p>3 got to be kidding.</p> <p>4 I used to always use an example that if</p> <p>5 you think that George Soros would let you know</p> <p>6 when he's going to -- when he was going short</p> <p>7 pound, he -- he wouldn't. So --</p> <p>8 And what you saw was a typical</p> <p>9 disclosure that most hedge funds to this day --</p> <p>10 but it's changing. There was no transparency.</p> <p>11 If you were a client of Paul Tudor</p> <p>12 Jones, with a typical hedge fund, you got a</p> <p>13 sheet of paper every quarter that said, your</p> <p>14 equity when you started was X dollars. It's now</p> <p>15 this dollars. You never knew whether you were</p> <p>16 in soybeans, potatoes, futures, equities.</p> <p>17 Nothing. That was it.</p> <p>18 The attitude was, you wanted to invest</p> <p>19 in a hedge fund. You put your money up. You</p> <p>20 take your chances and don't ask any questions.</p> <p>21 That's it.</p> <p>22 Because everybody was paranoid about</p> <p>23 everybody else copying their strategies, knowing</p> <p>24 when to go in the market and so on.</p> <p>25 Q. Who else did you meet from Optimal, other</p>

<p style="text-align: right;">82</p> <p>1 than Mr. Echeverria and Mr. Clark?  2 A. Well, they came up once, I believe,  3 with, you know, like one or two due diligence  4 people. It was -- it was difficult for me to  5 remember, because sometimes they had some of the  6 people from Bank Santander coming into meetings.  7 Sometimes it was people from Optimal  8 coming up. Sometimes it could have been -- but  9 not necessarily with them, but I don't know,  10 their auditors, you know, coming up.  11 It -- you know, it was very difficult  12 for me to -- to -- to know or to remember who  13 was coming, who I basically met with.  14 But clearly did not encourage meetings.  15 It was not -- I would spend endless amounts of  16 time --  17 Q. And how would you do that? How would you  18 not encourage meetings?  19 A. Well, I would -- what I would say to  20 people is, look, the strategy is a relatively  21 simple strategy. Okay. It is -- I'm never  22 going to tell you when I'm going into the market  23 or when I'm -- when I'm getting out of the  24 market.  25 I said, I'm only going to tell you if I</p>	<p style="text-align: right;">84</p> <p>1 that's what they were getting paid to do. And  2 as much -- as much as I --  3 Q. What do you mean by that, that that's what  4 they were getting paid to do?  5 A. Well, that's what -- that's what  6 they're -- they're managers. They're getting  7 paid from -- whether it be Banco Santander or  8 whether it be from their -- from their client.  9 And, don't forget, most of these clients  10 were investing for other hedge funds. So the  11 fund of funds, their clients, sometimes were  12 large network individuals. Sometimes they  13 were -- they were smaller hedge funds.  14 Sometimes larger hedge funds.  15 So you had, I guess, somebody like  16 Optimal investing for -- for banks like -- from  17 other Swiss banks, you know, who were saying --  18 who were, you know, pressing them for  19 information.  20 And the call I would always get is, is  21 Bernie in the market or out of the market?  22 Every time the market was up, they wanted to  23 make sure they were in the market. Every time  24 the market was down, they wanted out of the  25 market.</p>
<p style="text-align: right;">83</p> <p>1 change the strategy, which, quite frankly, I'm  2 not allowed to do, you know, without notifying  3 you, and I never did.  4 I said, so there is no reason for --  5 since I'm never going to tell you when I'm in  6 the market or out of the market until it's after  7 the fact, because I don't want you -- I'm not  8 going to telegraph what I'm doing, for obvious  9 reasons. Nor would anybody.  10 I said, so that -- and since you are  11 getting more disclosure than you get from any of  12 your other hedge fund investments. In other  13 words, they are getting within a couple of days  14 of the transaction a confirmation telling them  15 exactly what they own, a monthly statement that  16 tells them all of this.  17 They know what equities they're long,  18 what options they're long or short. They  19 understand all of that. That is something that  20 was unique to -- to our model.  21 And they didn't -- it was -- there was  22 not a reason to beat it to death all of the  23 time.  24 That being said, they always felt an  25 obligation to stay in touch with me, because</p>	<p style="text-align: right;">85</p> <p>1 So there was always this -- and I used  2 to say to them, you -- when you get your  3 confirmation, you'll know what you're -- what  4 you're doing.  5 Q. You mentioned previously the term due  6 diligence. Are you familiar with the term  7 operational due diligence?  8 A. Sure.  9 Q. And what is operational due diligence?  10 A. Operational due diligence normally means  11 to make sure that your back office, your  12 operations side of the business, my operations  13 side of the business, is equipped to handle  14 things like custody of the -- of their assets,  15 of actually clearing and settling the  16 transactions involved. That there are the risk  17 controls and there -- that -- that the  18 transactions can settle, take place.  19 It's a crucial part of -- of anybody  20 that has an account at any brokerage firm.  21 Q. And is it your general understanding that  22 part of operations and due diligence includes making  23 sure that transactions actually take place?  24 MR. REGAN: Objection.  25 You can answer.</p>

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86	<p>1 THE WITNESS: Well, that's -- it's very</p> <p>2 limited. Their ability to know that a</p> <p>3 transaction ever took place is, quite frankly,</p> <p>4 limited.</p> <p>5 BY MR. BLEICHMAR:</p> <p>6 Q. And why is that?</p> <p>7 A. Because, as I say, number one, brokerage</p> <p>8 firms typically trade sometimes on the long side</p> <p>9 or the short side of the market. They're not</p> <p>10 going to disclose that to a client.</p> <p>11 Q. Is -- is the ability -- is the reason</p> <p>12 clients are limited -- or one of the reasons why</p> <p>13 clients were limited in confirming whether the</p> <p>14 transactions took place in your case the fact that</p> <p>15 you self-cleared?</p> <p>16 MR. REGAN: Objection.</p> <p>17 You can answer.</p> <p>18 THE WITNESS: Well, it wouldn't matter</p> <p>19 whether I self-cleared or whether I cleared</p> <p>20 through a bank or another firm, because they</p> <p>21 would not have the ability to confirm with a</p> <p>22 clearing agent anything about my business.</p> <p>23 In other words, if you -- if you clear</p> <p>24 through Bear Stearns, your client could not call</p> <p>25 Bear Stearns up and ask them for any information</p>	88	<p>1 A. That is correct.</p> <p>2 Q. And was that a critical aspect of what</p> <p>3 eventually turned in to be an illegitimate business?</p> <p>4 MR. REGAN: Objection.</p> <p>5 You can answer.</p> <p>6 THE WITNESS: No.</p> <p>7 BY MR. BLEICHMAR:</p> <p>8 Q. Why not?</p> <p>9 A. Well, let me -- let me figure out how to</p> <p>10 address that. Well, I take that back. They</p> <p>11 would --</p> <p>12 Q. "They," meaning who?</p> <p>13 A. If the clearing firm that I was clearing</p> <p>14 business through, let's say, Bear Stearns, saw</p> <p>15 that I was not buying securities, they would</p> <p>16 know that Bernie is constantly short these</p> <p>17 securities, because unless for some reason I had</p> <p>18 the securities custodied somewhere else, other</p> <p>19 than them, they would say, well, he's buying and</p> <p>20 selling stock, and there's no deliveries</p> <p>21 physically coming in and out. So, yeah, they</p> <p>22 would be --</p> <p>23 Q. So the answer is, yes?</p> <p>24 A. Yeah. They would know that. They</p> <p>25 wouldn't be at liberty to disclose that to the</p>
87	<p>1 related to you, other than the fact --</p> <p>2 There is a big difference, though. Bear</p> <p>3 Stearns would be the one that would be sending</p> <p>4 them the confirmation. So they would know that</p> <p>5 Bear Stearns -- they would get a confirmation</p> <p>6 from Bear Stearns and a statement from Bear</p> <p>7 Stearns.</p> <p>8 However, Bear Stearns would not be free to</p> <p>9 disclose to the client whether or not the --</p> <p>10 whether or not I actually was long the security</p> <p>11 or short the security.</p> <p>12 BY MR. BLEICHMAR:</p> <p>13 Q. So, in other words, if you used Bear</p> <p>14 Stearns as the institution that issued the</p> <p>15 confirmations, that would be a difference in the way</p> <p>16 you -- the way BMIS --</p> <p>17 A. Right. The only -- the only --</p> <p>18 Q. -- BMIS conducted business?</p> <p>19 A. Yeah. The only difference would be they</p> <p>20 now had an independent name of someone, of a</p> <p>21 firm, that was, let's say, larger typically than</p> <p>22 me. Okay.</p> <p>23 Q. But in the BMIS situation the feeder funds</p> <p>24 only obtained confirmation of their trades based on</p> <p>25 BMIS-prepared confirmations?</p>	89	<p>1 client, but they would -- they would worry about</p> <p>2 it themselves.</p> <p>3 Q. Let me take a step back.</p> <p>4 Did the feeder funds, such as Optimal, have</p> <p>5 any way to independently verify that you were</p> <p>6 executing the trades for them?</p> <p>7 A. No.</p> <p>8 Q. And why is that?</p> <p>9 A. Because they do not have the ability to</p> <p>10 check with the custodian that I was using. They</p> <p>11 were of the opinion that --</p> <p>12 Q. And who was the custodian you were using?</p> <p>13 A. Depository Trust.</p> <p>14 All of --</p> <p>15 Q. There was no --</p> <p>16 A. Or -- and it was some of my banks that</p> <p>17 held treasuries for me.</p> <p>18 Q. And you were generating the confirmations</p> <p>19 yourself; correct?</p> <p>20 A. Correct.</p> <p>21 Q. Did you -- did BMIS keep segregated</p> <p>22 accounts in the name of the feeder funds?</p> <p>23 A. Yes, on my books and records. Yeah.</p> <p>24 Q. Did you keep -- did BMIS keep segregated</p> <p>25 accounts on behalf of the feeder funds at</p>

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90	<p>1 third-party institutions?  2 A. No.  3 Q. And why is that?  4 A. Because it typically was not done. DTC  5 would not have accounts typically for -- they  6 would have one account for the broker-dealer,  7 and that would be a commingled account, unless  8 the broker-dealer was borrowing money on the  9 securities.  10 Then they would have the account -- the  11 securities segregated in a loan account at DTC.  12 But since I was never -- I did not have margin  13 accounts with these clients, there was no  14 leverage being used for these clients, they  15 wouldn't have it.  16 Q. Did anyone from Optimal ever ask you  17 whether you had set up independent segregated  18 accounts on their behalf?  19 A. Not at DTC, because they say that was  20 not standard operating procedure. They --  21 they -- they asked. And we told them that on  22 our books and records, in our stock record, in  23 our records Optimal had an account, as did all  24 of the other funds in their name.  25 And the securities -- if you looked on a</p>	92	<p>1 corporation.  2 But in the options side, since it was an  3 over-the-counter option, it would be another  4 derivative dealer or a -- or a bank, or it could  5 have conceivably been an options-clearing  6 corporation.  7 Q. Did Optimal or anyone at Optimal ask you to  8 disclose the identity of the trading counterparties?  9 A. Yes.  10 Q. And did you disclose their identity?  11 A. No.  12 Q. And why not?  13 A. Well, I basically said, number one, I  14 mean, typically you would not disclose the name  15 of your counterparties for competitive reasons.  16 Q. Did the counterparties exist?  17 A. No.  18 MR. REGAN: I'm just going to object. I  19 think you have to give the witness a chance to  20 answer --  21 MR. BLEICHMAR: Oh, go ahead.  22 MR. REGAN: -- some of these questions.  23 I -- maybe you answered that last question,  24 but --  25 THE WITNESS: No. I mean --</p>
91	<p>1 stock record, it would show -- it would show  2 Optimal, Fairfield, so on and so forth, here on  3 X number of securities.  4 And the contra side of that would be  5 what's known as your box or the custodian, which  6 would be DTC. And they had a balance, if they  7 were -- if it was being entered properly, which  8 they were not -- not being, because there were  9 no securities on the DTC side.  10 Q. We've previously discussed counterparties;  11 right?  12 A. (WITNESS NODS HEAD UP AND DOWN.)  13 Q. Can you just briefly describe what --  14 again, what the role of the counterparties were in  15 the split-strike conversion strategy?  16 A. A counterparty is the person who is on  17 the other side of the transaction. Meaning  18 if -- and the counterparties in this situation  19 are the -- really are only important on the  20 derivative side, on the options side, because in  21 the equity side the counterparty was always  22 basically me, as principal, and the counter --  23 My counterparty would be another  24 broker-dealer, or, in reality, after the first  25 day of the trade, it would be the clearing</p>	93	<p>1 MR. REGAN: I think you're fairly  2 interrupting him.  3 THE WITNESS: Well, I -- you know,  4 obviously, I would not want to disclose the name  5 of a counterparty who didn't exist, because they  6 might have the ability to check with that  7 counterparty.  8 Now, typically a counterparty would not  9 necessarily disclose that, but you never know.  10 BY MR. BLEICHMAR:  11 Q. What was your understanding about BMIS'  12 obligation to disclose the name of a counterparty to  13 Optimal or the other feeder funds?  14 A. Well, in a counterparty, you know, when  15 you're acting as agent in a transaction, whether  16 it be on equity or whether it be a -- an option,  17 you're actually required to disclose the name of  18 a counterparty if they ask you that.  19 In other words, on the back of every  20 confirmation there's a legend that says, if we  21 acted as agent, the -- the -- the time of the  22 transaction and the -- the -- I forget the  23 language -- and the party to the transaction  24 will be disclosed upon request.  25 Q. And did Optimal ever request that</p>



<p style="text-align: right;">94</p> <p>1 information?  2 MR. REGAN: Objection.  3 You can answer.  4 THE WITNESS: They never asked it on the  5 equity side, but they asked it on the Optimal --  6 on the option side. That was, you know, asked a  7 number of times.  8 And my response always was that I do not  9 disclose the counterparty on the derivatives.  10 BY MR. BLEICHMAR:  11 Q. And what was their reaction to that?  12 A. Well, they weren't happy about it, but  13 they knew that was my -- that was going to be my  14 response, because that was my response to  15 everybody.  16 And, as I said, one fund always spoke to  17 another fund. So typically, because I would --  18 it would get back to me. The other fund would  19 say, you know, Optimal just called me up, and,  20 you know, said that, you know, they were up to  21 see you, and you wouldn't disclose the  22 counterparty.  23 And Optimal said, did he disclose the  24 counterparty to you, meaning Fairfield? And  25 they would say, no. He won't -- he won't</p>	<p style="text-align: right;">96</p> <p>1 the money back, because I'm not -- I'm not --  2 I'm not going to disclose that.  3 Q. And what did Optimal do?  4 A. Nothing. They said to me, don't worry  5 about it.  6 Q. "Don't worry about it." And what was your  7 reaction to that?  8 A. I said, fine. I said, I'm not.  9 Q. Do you believe, as a professional in the  10 finance industry for many decades, that that was  11 reasonable --  12 MR. REGAN: Objection.  13 Q. -- from their standpoint?  14 MR. REGAN: Objection.  15 THE WITNESS: I would say that you would  16 have to understand the mentality of the typical  17 hedge fund manager. They -- their livelihood  18 depended upon them maintaining their  19 relationship with me, which was a very  20 profitable relationship for them personally, as  21 well as for the -- the bank or their fund.  22 They had every reason to believe that, you  23 know, if they threatened to take their money  24 back, I would send it back to them, because  25 historically whenever they wanted money,</p>
<p style="text-align: right;">95</p> <p>1 disclose it.  2 Q. Did anyone at Optimal ever tell you if you  3 don't disclose the name of the counterparties, we  4 will withdraw our money?  5 A. Well, there was -- no. They never said  6 that. The closest it came to that was in the  7 late 2000's there was, I guess, a change in  8 regulations.  9 And I don't know whether it was Ireland  10 or Luxembourg, or wherever they were registered,  11 where they -- it was part of the Basel  12 agreement, whatever they -- they had to just --  13 they had to know who the counterparties on the  14 transactions in order for them to maintain their  15 registration.  16 So I received a phone call from a number  17 of these funds. One being Thema, and another  18 one being Optimal, for sure, that basically said  19 they have this directive now that they're  20 required to know the counterparty.  21 And I said, well, I'm -- you know, I'm  22 sorry, but I'm not disclosing that. And I said,  23 your -- you know, if -- if your -- if -- your  24 choice is to get the name of that or take the  25 money back, then you're going to have to take</p>	<p style="text-align: right;">97</p> <p>1 regardless of the amount, it could be hundreds  2 of millions of dollars, you know, within days of  3 them making the request the money was returned.  4 So they never doubted that I was not going  5 to release this information. Whether or not,  6 you know, that should have been a signal to  7 them, of course, that's a different issue.  8 BY MR. BLEICHMAR:  9 Q. When you say, "their" -- "their  10 livelihood," what are you referring to?  11 A. Their salary or fee, whatever they were  12 getting.  13 Q. And how -- how -- what was your  14 understanding of how that worked?  15 A. I never really knew or cared to know  16 what their fee was. I know what -- I sometimes  17 knew what the fee was that the hedge fund was  18 making, because it was part of their offering  19 documents, which sometimes I saw and sometimes I  20 didn't see.  21 But typically in a fund -- I think  22 Optimal was making one and a half percent of the  23 amount of money that they -- they managed.  24 Sometimes it was -- it included one to  25 one and a half percent, plus 20 percent of</p>

98	<p>1 whatever the profits that I earned on them,  2 which was standard with a firm like Fairfield.  3 Q. So what would happen if Optimal withdrew  4 the money that was invested with you?  5 A. Well, they would lose their fee. I  6 mean, I don't -- Fairfield, for example, made,  7 you know, over 100 million dollars a year from  8 me for their managers.  9 I don't know what Manuel's salary or  10 what his cut was, but I think Optimal was on  11 a -- sort of a one and a half percent. But one  12 and a half percent of a lot is a lot.  13 Q. So was it your impression that Optimal  14 didn't press you further on the name of the  15 counterparties, in part because of the fees they  16 were charging?  17 MR. REGAN: Objection.  18 You can answer.  19 THE WITNESS: I -- well, let's put it this  20 way, their choice was -- I didn't give them a  21 choice. Well, I did give them a choice. Their  22 choice was to not -- not get this information  23 and take their money or -- that was it, you  24 know.  25 And, of course, if they did that, their fee</p>	100	<p>1 A. No.  2 Q. Why not?  3 A. Well, knowing what I know, it was  4 something that, you know, I wouldn't -- you  5 know, I wouldn't do. The -- but, you know,  6 that's -- that's with my knowledge of both my  7 own -- what I was doing here and my knowledge in  8 the -- in the business.  9 Q. Putting --  10 A. No. In other words, based upon my  11 knowledge of what was happening in my own firm,  12 and also my knowledge of what goes on in the  13 industry, I wouldn't be investing in any hedge  14 funds, but that's a different issue.  15 Q. What was -- what was your understanding  16 about what was going on in the industry?  17 MR. REGAN: Objection.  18 You can answer.  19 THE WITNESS: Well, I don't know that  20 everybody in the industry was -- was committing  21 the crime that I was committing. I would say  22 that's probably not the case.  23 But what I would say is that there is a --  24 there is a culture and a systemic problem with  25 the industry, with the securities market today,</p>
99	<p>1 would have to be -- they wouldn't have a fee  2 from me. They would have to take -- put the  3 money somewhere else and hopefully make a fee  4 and a return, you know, somewhere else.  5 So, I mean, clearly they had -- the  6 manager, as did the bank, you know, would have  7 an ax to grind, you know, in this situation.  8 BY MR. BLEICHMAR:  9 Q. What do you mean by, "an ax to grind"?  10 A. Well, I mean the consequence of them  11 pressing me for -- for the counterparty was  12 basically to discontinue the relationship. That  13 was it.  14 Q. Did Optimal or Manuel ever ask you to  15 disclose, perhaps not all of the counterparties, but  16 perhaps only one counterparty?  17 A. No.  18 Q. Would you have invested in BMIS if you were  19 in Optimal's shoes and BMIS refused to identify any  20 of the counterparties?  21 MR. REGAN: Objection.  22 You can answer.  23 THE WITNESS: Me?  24 BY MR. BLEICHMAR:  25 Q. Yes.</p>	101	<p>1 that, quite frankly, makes it unsuitable for  2 anybody to invest, other than somebody that just  3 wants speculation.  4 Now, that's -- that's my feeling. It's --  5 it's always been that -- that -- I've always  6 been of that opinion. I've been very -- I've  7 been very -- people have been very critical of  8 me because of my opinion on hedge funds in  9 general from -- since the -- including the hedge  10 funds that I was dealing with, knew that I felt  11 that way.  12 And I think that now things that I've been  13 warning people about for years is -- is being  14 uncovered. It's a big casino.  15 And, although, not everybody may be doing  16 what I did, and certainly am -- I assume is not,  17 and committing out and outright fraud, but, for  18 all intents and purposes, what they are doing is  19 no better. It's just being masked or guised in  20 certain other things.  21 Now, that may sound self-serving and a  22 rationalization on my part, and I wouldn't blame  23 anybody for -- for feeling that way, but 50  24 years in the business, in every aspect of this  25 business, from the regulatory side to the</p>

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102	<p>1 operational side, to the marketing side, it's --</p> <p>2 it's a total disaster.</p> <p>3 BY MR. BLEICHMAR:</p> <p>4 Q. Going back to the issue of the fact --</p> <p>5 excuse me. Going back to the issue of the fact that</p> <p>6 you did not disclose any of the counterparties,</p> <p>7 putting aside that you knew that you were committing</p> <p>8 a fraud, if you were in Optimal's shoes, and you</p> <p>9 were going to invest in BMIS and BMIS was not going</p> <p>10 to disclose the name of the counterparties, would</p> <p>11 you have invested in BMIS?</p> <p>12 MR. REGAN: Objection.</p> <p>13 You can answer, if you can.</p> <p>14 THE WITNESS: Well, in fairness to Optimal,</p> <p>15 or to any of my clients, I had a reputation in</p> <p>16 the industry that was, you know, a very good</p> <p>17 reputation.</p> <p>18 I had a substantial amount of capital that</p> <p>19 ranked me within the top couple of percent of</p> <p>20 the securities industry in capital. And,</p> <p>21 considering the type of business I did, that was</p> <p>22 even more substantial.</p> <p>23 The -- and, you know, I had a pedigree from</p> <p>24 the regulatory side and an image, which, of</p> <p>25 course, now had been totally, you know,</p>	104	<p>1 with that. You know, I destroyed, most</p> <p>2 importantly, my family.</p> <p>3 And it is -- it was never done, in spite</p> <p>4 of the fact of what people might think, to be</p> <p>5 able to be successful and make money, because I</p> <p>6 was worth well over a billion dollars before I</p> <p>7 came off the tracks.</p> <p>8 It was partly ego. Partly I just was</p> <p>9 convinced that I would be able to accomplish</p> <p>10 what I wanted to accomplish. I had always done</p> <p>11 that. You know, I had -- against all odds I had</p> <p>12 built a business, a market making business, that</p> <p>13 everybody said was impossible to build.</p> <p>14 I had gained a huge amount of respect.</p> <p>15 I fought, you know, the establishment, the</p> <p>16 industry, the regulators, everybody, to build a</p> <p>17 business. And I did a lot of good. I also made</p> <p>18 a lot of people very, very wealthy.</p> <p>19 And, in spite of what I did, no one in</p> <p>20 my opinion will be a net loser on this</p> <p>21 situation. Of course, none of that gets</p> <p>22 reported or hasn't yet.</p> <p>23 Although, people understand that, but</p> <p>24 for 35, 36 years I ran a perfectly legitimate</p> <p>25 business and made a great deal of wealth</p>
103	<p>1 discredited.</p> <p>2 So the big question, quite frankly, in</p> <p>3 everybody's mind, from the day that this thing</p> <p>4 was uncovered until probably today, present day,</p> <p>5 was why did Bernie do this.</p> <p>6 I mean, everybody was -- it was an</p> <p>7 embarrassment to the SEC, to the NASD, to -- to</p> <p>8 everyone.</p> <p>9 BY MR. BLEICHMAR:</p> <p>10 Q. So why did you do it?</p> <p>11 A. Well, because I allowed myself</p> <p>12 foolishly, as I said, to be trapped into</p> <p>13 something. And what I looked at as being a</p> <p>14 temporary situation, that was going to work out</p> <p>15 well for everyone, my clients, as well as</p> <p>16 myself, I, you know, decided to take the risk</p> <p>17 and convinced myself that it was going to work</p> <p>18 out.</p> <p>19 I then, after awhile, became aware of</p> <p>20 the fact that I was not going to be able to</p> <p>21 extricate myself from this mess, and then didn't</p> <p>22 have the courage or the character, you know,</p> <p>23 to -- to fess up to it.</p> <p>24 And it's something that, you know, I</p> <p>25 live with every day and try to come to grips</p>	105	<p>1 possible for everyone, including myself.</p> <p>2 So when you do that, you -- you develop</p> <p>3 a sense of confidence that you can pretty much,</p> <p>4 you know, do anything, you know.</p> <p>5 And you also have to understand that --</p> <p>6 which is something that I'm trying to work with</p> <p>7 with Harvard and other people in, is that</p> <p>8 there's a culture that exists in Wall Street and</p> <p>9 in business in general that, you know, things</p> <p>10 are done that the lines get blurred, and that</p> <p>11 as, I guess, even Steve Jobs felt in his book,</p> <p>12 rules don't apply to -- to everybody.</p> <p>13 It's -- it's -- it's ridiculous, but</p> <p>14 it's a fact of life.</p> <p>15 And I -- I wish I could -- I wish I</p> <p>16 could acknowledge the fact that I knew that what</p> <p>17 I was doing -- that I didn't know what I was</p> <p>18 doing was wrong or that it was against the law,</p> <p>19 but I operated in a business that every day</p> <p>20 people do that to a certain extent, and it works</p> <p>21 out.</p> <p>22 And, quite frankly, which is being</p> <p>23 demonstrated now as at every level of the</p> <p>24 business, from the highest level on, people</p> <p>25 break rules, violate trust, violate the</p>

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106	<p>1 fiduciary capacity, and nothing goes unpunished.  2 It's, you know, from the treasury  3 secretary, you know, on down, and everybody  4 stands there. And there's one article or  5 editorial after another in the newspapers today  6 that basically confirms that.  7 It's -- you know, it doesn't make me  8 feel any better. It's something that I knew all  9 along, and maybe had a greater impact on my  10 psyche than I thought that allowed me to -- to  11 do this.  12 But you have to understand that for 50  13 years I operated at every level of this industry  14 and was witness to all of the rules and  15 regulations. I -- I've framed most of them in  16 the trading industry.  17 I was on the committees that built them.  18 I served on the federal regulation committee,  19 which includes the general counsels of every  20 firm, primary firm, in Wall Street, and for  21 longer than anybody in the industry.  22 And I watched general counsels of the  23 major firms acknowledge that their firms were  24 violating the rules left and right, that the  25 CEOs knew what was going on, to the point where</p>	108	<p>1 I live with that, you know, with that -- my son  2 took his own life because of -- because of what  3 I did. So --  4 But me feeling sorry, it doesn't change  5 anything, you know. The only thing I --  6 that's -- the only thing that I feel good about  7 was that when offered a deal by the prosecutor  8 to -- to, you know, come forward and cooperate  9 to get a lower sentence, I refused to do that.  10 And my attorneys didn't understand it,  11 advised me not to do this, but -- you know, not  12 to not cooperate, but I said at the time, and  13 since then has been proven to be correct, that  14 the best thing I could do for my clients was  15 to -- to get the money back from the people that  16 were complicit in the crime. Namely, Picower,  17 Shapiro, Levy and some of these other people.  18 I said that --  19 Q. Why were they complicit?  20 A. Well, because they had violated tax laws  21 based upon what I discussed with them and other  22 things that I knew that they were doing with  23 people in my firm, bookkeepers, who are all now  24 under investigation.  25 And I said, look, I have nothing to lose</p>
107	<p>1 they refused to certify what the SEC wanted them  2 to certify that everything was okay.  3 And their response was, I'm not  4 certifying this. And you're going to jail,  5 because I know -- let the CEO certify them,  6 these documents, and that way they'll have the  7 money. You know, I'm not expendable, but -- I  8 mean, I'm expendable. They're not.  9 So none of this makes me feel any  10 better. Okay. And it's probably not going to  11 make anybody else feel any better, but it's --  12 it's a -- it's pathetic, but that's what is --  13 that is what is going on, and it had an impact  14 on me.  15 So when you ask, why did I do it, I ask  16 myself that every day, every day. And I'm sure  17 my family asks that every day. And the  18 regulators ask it.  19 Mary Shapiro has probably been mortified  20 and embarrassed, you know, as the chairman of  21 the SEC, you know, who has a close relationship  22 with me. So does a lot of the other attorneys  23 work there.  24 Q. Are you sorry about what you did?  25 A. Of course I'm sorry. I mean, you know,</p>	109	<p>1 at this stage. No matter what I do, no matter  2 how I cooperate, I'm going to be sentenced to a  3 long term. I'm going to wind up probably dying  4 in prison.  5 And these people are all aware of the  6 fact that I have information that will send them  7 to prison. That, you know, the best thing I can  8 do would be to let these people know that unless  9 they come forward with the money, return it, and  10 the investors get -- become whole, then I am  11 going to give the evidence to the government  12 that I have.  13 This was not good enough for the  14 government to reduce my sentence or anything  15 else. And I said, okay. I said, it's sort of  16 academic, as far as I'm concerned.  17 I said, you want criminal information.  18 I said, criminal information is not going to  19 matter, because these people are going to be  20 dead anyhow by the time you bring it.  21 They're 90 some odd years old, other  22 than Picower. I said, his health is  23 questionable. He'll never survive long enough  24 anyhow. He's had four quadruple bypasses, you  25 know.</p>

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110	<p>1 I said, it's -- you'd have to let me do</p> <p>2 this my way. I contacted these people, and I</p> <p>3 said to them -- I laid it out to them. I said,</p> <p>4 look -- when I was on bail, I said, you either</p> <p>5 come forward or I'm going to release the</p> <p>6 information.</p> <p>7 Q. When you say, "these people," who are you</p> <p>8 referring to?</p> <p>9 A. Picower, Shapiro.</p> <p>10 And then -- believe me, I had it. And</p> <p>11 it took a year for Picower to finally say to me,</p> <p>12 okay. I'll come down. Let me have this</p> <p>13 information, you know. He said --</p> <p>14 And I said, I'm not -- you know, fine.</p> <p>15 I said, it's -- there's no conditions attached</p> <p>16 to it. I said, I'll give you the information.</p> <p>17 I'll tell you where to look.</p> <p>18 By that time, you know, Picower --</p> <p>19 Q. Picower?</p> <p>20 A. Yeah -- no. Picower was dead.</p> <p>21 Q. Okay. So who came down?</p> <p>22 A. He drowned in a swimming pool.</p> <p>23 Picard and his attorneys. They came</p> <p>24 down for two days. They had six or eight</p> <p>25 attorneys spend two days -- four days here. And</p>	112	<p>1 an estate of nine billion dollars. So I</p> <p>2 thought, not only was I stupid, you know, the</p> <p>3 guy lied to me. Which, of course, you know, I</p> <p>4 guess, I lied to a lot of other people. So --</p> <p>5 Well, his wife, of course -- he -- he</p> <p>6 died of a heart attack in a pool. I'm sure it</p> <p>7 was inflicted by knowing what was going to</p> <p>8 happen.</p> <p>9 She came forward with the seven billion</p> <p>10 dollars. Shapiro came forward with close to a</p> <p>11 billion dollars in reality. Levy's family came</p> <p>12 through with 250. Other banks came through with</p> <p>13 500. This one did a billion. This one --</p> <p>14 The reality of it is, the money is all</p> <p>15 going to be recovered. At least that's my --</p> <p>16 and this -- this has nothing to do with the</p> <p>17 billions of dollars that all of these people</p> <p>18 made for the first 35 years of doing business</p> <p>19 with me.</p> <p>20 So it's a longwinded way of saying, how</p> <p>21 did it happen, why did it happen, do I feel</p> <p>22 remorse. I don't have a -- a son. I lost my</p> <p>23 son. For all intents and purposes I've lost the</p> <p>24 rest of my family, and I turned what would have</p> <p>25 been a great legacy into a total disaster.</p>
111	<p>1 I laid out all of this information.</p> <p>2 Of course, Picard said, well, we sort of</p> <p>3 know about this, because we can see what you did</p> <p>4 and this. I said, fine. I said, look, I said,</p> <p>5 you know, you're going to get the money back.</p> <p>6 And, of course, everybody said it was a</p> <p>7 pipe dream. They said, this is not going to</p> <p>8 happen. You know, no one is going to come</p> <p>9 forward with all of this money.</p> <p>10 And I said, it -- I can't guarantee it,</p> <p>11 but I -- I said, I know it's going to happen,</p> <p>12 because these people, you know, really have no</p> <p>13 choice.</p> <p>14 And at this time I became aware of the</p> <p>15 fact that Picower had an estate of nine billion</p> <p>16 dollars. It was reported in the papers. So, in</p> <p>17 spite of the fact that he told me he was wiped</p> <p>18 out and couldn't have -- didn't have the money,</p> <p>19 which is why I started doing all of this,</p> <p>20 because I realized he's not going to be able to</p> <p>21 make me whole, and I'm not going to be able to</p> <p>22 make the money I lost on the hedges. So that's</p> <p>23 what started this whole cycle.</p> <p>24 You can imagine how I felt when being in</p> <p>25 prison I read in the newspapers that the guy had</p>	113	<p>1 So, you know, do I feel guilty with some</p> <p>2 of my investors? Yes. There were some people</p> <p>3 that were friends of mine, who could never</p> <p>4 imagine or believe that I would do this.</p> <p>5 And, of course, they'll never believe</p> <p>6 that I thought it was a temporary situation,</p> <p>7 but, you know, I would be less than human.</p> <p>8 But, according to my psychologist, who I</p> <p>9 spend endless time with, for someone who never</p> <p>10 believed in getting help, was not a thing that</p> <p>11 Jewish people did, as you know, the -- people</p> <p>12 compartmentalize things, is the term, the</p> <p>13 psychological term they use. That's how --</p> <p>14 Q. Is that what you did?</p> <p>15 A. Yeah. I mean, that's what she claims.</p> <p>16 I mean, mafia people kill people all day long.</p> <p>17 And I sit out in the yard with one of them, who</p> <p>18 is, you know, Carmine Persico, who was accused</p> <p>19 of killing 21 people, and he's the sweetest man.</p> <p>20 And family comes down and visits him,</p> <p>21 and he sits here. And you talk to this guy, and</p> <p>22 you think this can't be someone that would be a</p> <p>23 cold-blooded murderer. And I'm sure people say</p> <p>24 that about me, you know.</p> <p>25 So, look, I never understood how people</p>

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114	<p>1 go to war and kill people, and it turns out that</p> <p>2 they don't survive, a lot of them, you know.</p> <p>3 This posttraumatic stress is becoming more and</p> <p>4 more common, you know. So people do it.</p> <p>5 And I guess -- look, and I -- I -- I</p> <p>6 can't tell you that I didn't sit there every day</p> <p>7 and say, what I'm doing is wrong, and I should</p> <p>8 be punished. I knew I would be eventually, but</p> <p>9 I didn't know how to get out of it.</p> <p>10 And I was responsible for 200 employees</p> <p>11 that never worked for anybody, other than me,</p> <p>12 and were following me blindly, not knowing</p> <p>13 what -- not having a clue as to what I was</p> <p>14 doing.</p> <p>15 My own son didn't -- sons didn't know</p> <p>16 this, nor did my wife, nor did my brother.</p> <p>17 They --</p> <p>18 You know, how I did that is something</p> <p>19 I -- I still can't figure out. I -- I figured I</p> <p>20 would die from the stress, you know. It's -- I</p> <p>21 think someone should do a study of my brain to</p> <p>22 figure out how I -- I don't think anybody can</p> <p>23 figure that out. You know, I certainly can't.</p> <p>24 So if you ask me, do I have remorse? I</p> <p>25 don't know how you could have any more remorse</p>	116	<p>1 A. Well, they -- they -- in the beginning,</p> <p>2 I would say that most people would not disclose</p> <p>3 how much money they had to work.</p> <p>4 There was a difference between me and a</p> <p>5 hedge fund. A hedge fund always had to disclose</p> <p>6 how much money they had working. It was part of</p> <p>7 their marketing thing.</p> <p>8 The more money that they had working for</p> <p>9 them, the more people felt comfortable with</p> <p>10 them. It showed that they had, you know, a lot</p> <p>11 of credibility. They had a lot of power and so</p> <p>12 on.</p> <p>13 Brokerage firms, for the most part,</p> <p>14 would never disclose this. I mean, some of the</p> <p>15 bigger ones do now. Again, for the same reason</p> <p>16 that hedge funds do it.</p> <p>17 But smaller hedge funds, or the</p> <p>18 old-fashioned hedge funds, like George Soros,</p> <p>19 Julian Robertson, those people, that culture</p> <p>20 never disclosed any of this kind of information.</p> <p>21 So it was not unusual at that stage for</p> <p>22 me to say, look, I'm not disclosing that. It's</p> <p>23 substantial. And that was all I would say.</p> <p>24 At a later date, when the number became</p> <p>25 so large, it would have then been a signal that</p>
115	<p>1 than I have.</p> <p>2 MR. BLEICHMAR: Why don't we take a break.</p> <p>3 MR. REGAN: Okay.</p> <p>4 (RECESS FROM 10:17 A.M. TO 10:48 A.M.)</p> <p>5 MR. BLEICHMAR: All right. Let's just go</p> <p>6 back on the record.</p> <p>7 BY MR. BLEICHMAR:</p> <p>8 Q. Mr. Madoff, earlier we were discussing</p> <p>9 Optimal and the disclosures that you made to</p> <p>10 Optimal; correct?</p> <p>11 A. Uh-huh.</p> <p>12 Q. Did Optimal ask you to disclose the amount</p> <p>13 of assets under management of BMIS?</p> <p>14 A. Yes, they did.</p> <p>15 Q. And did you disclose that?</p> <p>16 A. No.</p> <p>17 Q. And why not?</p> <p>18 A. Well, the real reason was that I didn't</p> <p>19 want them to know how much money was under</p> <p>20 management, because it was a large amount. And</p> <p>21 it would have made the credibility of the</p> <p>22 ability to put that much money to work, you</p> <p>23 know, very difficult at that stage when they</p> <p>24 started to ask me that.</p> <p>25 Q. And why -- go ahead.</p>	117	<p>1 there was a potential problem.</p> <p>2 Q. And did Optimal or anyone at Optimal</p> <p>3 pressure you in any way to disclose the amount of</p> <p>4 assets under management?</p> <p>5 MR. REGAN: Objection.</p> <p>6 You can answer.</p> <p>7 THE WITNESS: Periodically people would ask</p> <p>8 the same question, you know.</p> <p>9 BY MR. BLEICHMAR:</p> <p>10 Q. And when you say, "people," who -- who are</p> <p>11 you referring to?</p> <p>12 A. Managers.</p> <p>13 Q. So other managers, other than Optimal?</p> <p>14 A. Right.</p> <p>15 Q. And why would the size of the assets under</p> <p>16 management that you had, in your view, would have</p> <p>17 indicated a problem?</p> <p>18 A. The market impact.</p> <p>19 Q. And what does that mean?</p> <p>20 A. Meaning that when I was moving in and</p> <p>21 out of the market it would be more difficult to</p> <p>22 not move the prices.</p> <p>23 Q. We talked about counterparties earlier;</p> <p>24 correct?</p> <p>25 A. Uh-huh.</p>

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118	<p>1 Q. Did Optimal ever ask you or anyone at</p> <p>2 Optimal ever ask you to see copies of option</p> <p>3 agreements with the counterparties?</p> <p>4 A. No.</p> <p>5 Q. And why would the option agreements with</p> <p>6 the counterparties have been important?</p> <p>7 MR. REGAN: Objection.</p> <p>8 You may answer.</p> <p>9 THE WITNESS: Well, typically you would</p> <p>10 want to see them to make sure that you had them.</p> <p>11 I mean, it was standard operating procedure of</p> <p>12 an over-the-counter option for there to be a</p> <p>13 contract.</p> <p>14 Now, typically the contract would have the</p> <p>15 name of the counterparties on them. Our</p> <p>16 particular option contract did not have the</p> <p>17 name, but it did say that the name would be</p> <p>18 disclosed upon a default, because they had --</p> <p>19 that would have been necessary in order for them</p> <p>20 to be able to settle the transaction, because</p> <p>21 they -- since I was acting as an agent, they</p> <p>22 would have to know who the other party was.</p> <p>23 But the thing that Optimal did not pick up</p> <p>24 on, nor did any of the other funds pick up on,</p> <p>25 was that because I was acting as an agent, that</p>	120	<p>1 BY MR. BLEICHMAR:</p> <p>2 Q. And why would that have been important?</p> <p>3 A. Well, it would have eliminated a lot of</p> <p>4 the dealers. I mean, there's maybe 20 dealers</p> <p>5 theoretically. You may have called 15 of them.</p> <p>6 You're not getting an answer.</p> <p>7 Now, if I was doing business with them,</p> <p>8 they probably would have said, I can't disclose</p> <p>9 that. But since I wasn't doing business with</p> <p>10 them, they would say, no.</p> <p>11 And I do know that -- or at least I read</p> <p>12 that in some documents that I received from</p> <p>13 somebody, from some lawyers, that a question was</p> <p>14 asked of some dealers, and they said, no.</p> <p>15 Q. And what -- and what does that mean to you?</p> <p>16 A. It calls into question whether or not I</p> <p>17 was doing the contract.</p> <p>18 Q. Did Optimal ask you whether Optimal --</p> <p>19 well, let me start a step before that.</p> <p>20 Does the phrase doing a walkthrough of a</p> <p>21 trade --</p> <p>22 A. Do what?</p> <p>23 Q. Do a walkthrough of a trade, is --</p> <p>24 A. A walkthrough of a trade?</p> <p>25 Q. Yeah.</p>
119	<p>1 information was required to be disclosed if</p> <p>2 somebody asked for it.</p> <p>3 So what they should have done was say,</p> <p>4 look, you're required to disclose this</p> <p>5 information. They never did that, nor did</p> <p>6 anybody else.</p> <p>7 BY MR. BLEICHMAR:</p> <p>8 Q. Is there anything else that, in your view,</p> <p>9 they should have done that they didn't do?</p> <p>10 MR. REGAN: Objection, but you can answer.</p> <p>11 THE WITNESS: There was nothing else that</p> <p>12 they really could have done. What they could</p> <p>13 have done, which I'm not sure whether they did</p> <p>14 or did not do, was speak to other derivative</p> <p>15 dealers and find out did I -- because they were</p> <p>16 of the opinion that I was using derivative</p> <p>17 dealers.</p> <p>18 Now, there's a limited number of derivative</p> <p>19 dealers that were in the -- that would handle</p> <p>20 this kind of business, people like Credit</p> <p>21 Suisse, Goldman, Merrill, so on.</p> <p>22 Now, they -- they may have asked them, and</p> <p>23 they may have, you know, said, are you doing</p> <p>24 business with Madoff? Since they weren't, they</p> <p>25 would have typically gotten an answer, no.</p>	121	<p>1 What does that mean to you?</p> <p>2 A. A walkthrough of a trade would be,</p> <p>3 explain to me what you do, how you put -- set</p> <p>4 the trade up. And typically -- and we would --</p> <p>5 we would do that.</p> <p>6 Some people did ask us that. And we</p> <p>7 would say -- you know, we would explain that</p> <p>8 we -- first of all, they were of -- we had a</p> <p>9 system, an electronic system, that we had built</p> <p>10 that used to do the -- used to do the trades</p> <p>11 that would --</p> <p>12 It was a system called -- well, it was a</p> <p>13 system that we developed, called Primex Trading</p> <p>14 System, which was a system that we originally</p> <p>15 built that we developed. Meaning BMIS developed</p> <p>16 it.</p> <p>17 And took on as partners Merrill Lynch,</p> <p>18 Goldman Sachs, Morgan Stanley and Smith Barney.</p> <p>19 So the five of us were partners in this system.</p> <p>20 We owned 50 percent. The rest of them all owned</p> <p>21 lesser amounts.</p> <p>22 Which was a trading platform that was</p> <p>23 going to compete with the New York Stock</p> <p>24 Exchange. Very similar to what's now referred</p> <p>25 to as the Dark Pools, but at that time it --</p>

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122	<p>1 that did not exist.</p> <p>2 That was a system that was developed</p> <p>3 that was -- had a tremendous amount of fanfare,</p> <p>4 because of who my partners were and the fact</p> <p>5 that we had developed it.</p> <p>6 So there was huge coverage in the Wall</p> <p>7 Street Journal and so on about this. And this,</p> <p>8 I guess, must have been in the early 2000's,</p> <p>9 something of that sort.</p> <p>10 And it was such a threat to the New York</p> <p>11 Stock Exchange that the New York Stock Exchange</p> <p>12 bought off my partners by making side deals with</p> <p>13 them on the specialists posted on the floor,</p> <p>14 rather than have them send the business to me.</p> <p>15 So all of a sudden all of my partners,</p> <p>16 except Citicorp, which was now -- which was part</p> <p>17 of -- Smith Barney was part of, were all</p> <p>18 basically out of the system, and it just was</p> <p>19 myself and Citicorp.</p> <p>20 And that system we wound up never really</p> <p>21 getting off the ground, but we sold it -- we</p> <p>22 sold parts of it to NASDAQ, and NASDAQ used this</p> <p>23 for their opening -- to open their markets and</p> <p>24 close it today.</p> <p>25 It's a system that was owned by a</p>	124	<p>1 It would -- the software would -- and it</p> <p>2 had artificial intelligence in it that would do</p> <p>3 all of this. And we would -- so we would --</p> <p>4 when the system gave us a signal that this is</p> <p>5 the time to go into the market, because of the</p> <p>6 decision that I had made that the market looked</p> <p>7 like it was going to have a spike up, and the</p> <p>8 system said, okay, you can buy these securities</p> <p>9 at these prices in these denominations. Go into</p> <p>10 the market to do it.</p> <p>11 Now, it would be limited to how much</p> <p>12 size you could do in that system without moving</p> <p>13 the market itself, which was another reason why</p> <p>14 we never wanted to disclose how much we were</p> <p>15 managing.</p> <p>16 But from the walkthrough stage we would</p> <p>17 explain that what we would do is we would have</p> <p>18 this system that would give us this information,</p> <p>19 that we would go out into the marketplace and</p> <p>20 interact and buy these securities.</p> <p>21 Once we did that, sometimes afterwards</p> <p>22 we'd call it a leg-in, we would sell the options</p> <p>23 against those transactions. And then we would</p> <p>24 have nothing to do, other than to have the trade</p> <p>25 settle. That was -- that was the walkthrough.</p>
123	<p>1 separate company that I owned. And my brother</p> <p>2 was primarily the -- the main person in it. So</p> <p>3 we had that system available.</p> <p>4 And what I did was -- was jerry-rigged</p> <p>5 that system so that we could use it as a routing</p> <p>6 mechanism to broker-dealers in Europe that</p> <p>7 theoretically could have executed this trade --</p> <p>8 these trades the way we were going to use Morgan</p> <p>9 Stanley, Merrill Lynch and so on and on.</p> <p>10 So the system was a legitimate system.</p> <p>11 It was used for that. But after it -- after we</p> <p>12 basically closed the system down, I took that</p> <p>13 system down for myself and used it as a -- what</p> <p>14 was going to be the mechanism to do trades, if I</p> <p>15 was doing it legitimately. And while it never</p> <p>16 got to that level.</p> <p>17 So we -- the walkthrough of the trade</p> <p>18 would be typically -- whether we were using that</p> <p>19 system or not, we would say, look, we go out.</p> <p>20 We have a model, which was a real model that</p> <p>21 would tell us when we -- what securities we</p> <p>22 would buy, which of the 50 or 35 securities we</p> <p>23 would buy, and what prices we should bid for</p> <p>24 them, how many shares we should buy and then how</p> <p>25 many hedges we should put on and so on.</p>	125	<p>1 It was a typical arbitrage-style</p> <p>2 transaction. A little bit more complicated than</p> <p>3 just going out and buying stock, because you</p> <p>4 also had to buy the options, and you had to buy</p> <p>5 the stocks at various levels and so on and so</p> <p>6 forth.</p> <p>7 But we had -- we had the technology to</p> <p>8 do that, because it was well-known that we had</p> <p>9 probably the most advanced order execution</p> <p>10 technology that existed on Wall Street and were</p> <p>11 able to handle hundreds of thousands of</p> <p>12 transactions, which was why people believed --</p> <p>13 people that understood it, you know, knowing</p> <p>14 what we could -- were capable of, doing this</p> <p>15 kind of trading was not so unusual to them.</p> <p>16 Q. You mentioned that a certain amount of</p> <p>17 assets could be seen as indication of being able to</p> <p>18 move the market; right?</p> <p>19 A. Right.</p> <p>20 Q. In your mind what amount of assets would</p> <p>21 lead to that effect?</p> <p>22 MR. REGAN: Objection.</p> <p>23 BY MR. BLEICHMAR:</p> <p>24 Q. Towards the end of, you know, the time</p> <p>25 where you were actually -- towards -- closer to</p>



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126	<p>1 2008.</p> <p>2 MR. REGAN: Objection.</p> <p>3 Go ahead.</p> <p>4 THE WITNESS: Well, the only -- the only</p> <p>5 amount that we actually disclosed, which was</p> <p>6 when we filed our -- in 2006, when we filed our</p> <p>7 investment advisory form, and that was a number</p> <p>8 of 16 billion.</p> <p>9 So 16 billion was a number. Although, it</p> <p>10 was always bandied around that it was much</p> <p>11 larger than that. So the rumors were that we</p> <p>12 were managing 21 billion.</p> <p>13 I don't think anyone ever thought it was 60</p> <p>14 some odd billion dollars, but -- which is what</p> <p>15 it was at the end with all of the artificial</p> <p>16 profits.</p> <p>17 But I would say that most people did not</p> <p>18 believe that it was only 16 billion, and were</p> <p>19 probably relieved when they only saw it was 16</p> <p>20 billion, because the story was that it was, you</p> <p>21 know, in the 20's.</p> <p>22 Which no one really had any knowledge,</p> <p>23 except one fund spoke to another. So if one</p> <p>24 fund said, well, how much is Fairfield, because</p> <p>25 those numbers were available.</p>	128	<p>1 BY MR. BLEICHMAR:</p> <p>2 Q. Switching to another topic. Did -- in</p> <p>3 talking about the reporting of the trades and the</p> <p>4 fact that BMIS did the reporting, did Optimal ever</p> <p>5 ask you whether the reporting of the trades could be</p> <p>6 changed, that there would be an external reporting</p> <p>7 entity?</p> <p>8 A. Yeah. Optimal -- Optimal, as well as</p> <p>9 other firms, wanted to -- asked if we would</p> <p>10 report the trades to them through DTC. DC --</p> <p>11 DTC had what they called a -- it was a DTC ID</p> <p>12 system.</p> <p>13 And a lot of the hedge funds used -- the</p> <p>14 brokers would report the trades electronically</p> <p>15 to DTC, and DTC would report it to the hedge</p> <p>16 funds.</p> <p>17 It was -- it was -- I don't remember</p> <p>18 what year it came on stream, but certainly in</p> <p>19 the 2000's that was what was -- was being done.</p> <p>20 Not every firm -- hedge -- you know, did</p> <p>21 it. We refused to do it, in spite of the fact</p> <p>22 that we were asked to do it. I mean, for</p> <p>23 obvious reasons.</p> <p>24 Q. And what were those reasons?</p> <p>25 A. The obvious reasons were we weren't</p>
127	<p>1 BY MR. BLEICHMAR:</p> <p>2 Q. Right.</p> <p>3 A. So if you did a little homework, and you</p> <p>4 said, well, Fairfield says they have six</p> <p>5 billion, and Thema has four billion, and this --</p> <p>6 Optimal has four billion, or whatever the</p> <p>7 numbers are, you could add it up. And --</p> <p>8 But, as I say -- so -- well, we'll --</p> <p>9 you know, the fact that we had 16 billion that</p> <p>10 we claimed, which was based upon our -- our</p> <p>11 investment advisory form, was the right number</p> <p>12 to disclose, according to our attorneys.</p> <p>13 The -- the funds always thought it</p> <p>14 was -- they knew -- they could have known, or</p> <p>15 should have known, that it was -- it was more</p> <p>16 than that.</p> <p>17 Q. And at the end technically, with all of the</p> <p>18 inflation, did you just say the number was closer to</p> <p>19 60 million -- 60 billion?</p> <p>20 A. Sixty --</p> <p>21 MR. REGAN: Objection.</p> <p>22 Go ahead.</p> <p>23 THE WITNESS: Sixty billion was the amount</p> <p>24 in the accounts at the end of the demise of the</p> <p>25 firm.</p>	129	<p>1 doing the trades. So we couldn't report air to</p> <p>2 DTC. So we said that, no. We're not going to</p> <p>3 do that.</p> <p>4 And some firms balked at that, but no</p> <p>5 one withdrew their business, that we know of,</p> <p>6 because of it.</p> <p>7 The -- it was just something that we</p> <p>8 said, look, we have our own systems. We're not</p> <p>9 going to rely upon DTC. We don't want to</p> <p>10 disclose that information to DTC.</p> <p>11 We don't want them -- no one really</p> <p>12 trusted the -- quite frankly, no one trusted the</p> <p>13 depositories. There had been situations where</p> <p>14 people found out from DTC by favors that people</p> <p>15 would do with them, they would send the guy ball</p> <p>16 game tickets and that, would just be able to</p> <p>17 find out what each firm's long positions were or</p> <p>18 short positions were.</p> <p>19 So this was when I was -- even when I</p> <p>20 was chairman, it was something we warned firms</p> <p>21 about doing, saying -- you know, we said, look,</p> <p>22 you're talking about a clerk, who is making</p> <p>23 \$30,000 a year, all of a sudden being offered,</p> <p>24 you know, a new Mercedes to disclose what</p> <p>25 Goldman Sachs' positions were.</p>

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130	<p>1 I said, you know, I don't know how</p> <p>2 you -- you -- you solve that problem.</p> <p>3 So firms -- it wasn't that unusual that</p> <p>4 we wouldn't use that system, but I guess if you</p> <p>5 add up all of the different things that we were</p> <p>6 mysterious about, it would ring alarm bells with</p> <p>7 certain firms.</p> <p>8 Q. And why would that be?</p> <p>9 A. Well, because, you know, it's just that</p> <p>10 it became -- you know, there were -- look, there</p> <p>11 were hedge funds that blew up. There was Bayou</p> <p>12 Capital.</p> <p>13 There were other ones that had -- were</p> <p>14 doing similar things that I was doing that</p> <p>15 what -- that turned out to be total frauds.</p> <p>16 And whenever -- whenever one of those</p> <p>17 things would occur and surface, I would get a</p> <p>18 ton of phone calls from my nervous clients.</p> <p>19 They'd say, you're not Bayou Capital, are you?</p> <p>20 You're not the same thing?</p> <p>21 And I would laugh it off and say, no.</p> <p>22 When, in fact, I was.</p> <p>23 Q. Did Optimal ever ask you if you were --</p> <p>24 A. They all were.</p> <p>25 Q. -- Bayou Capital?</p>	132	<p>1 original types of hedge funds, as I said, they</p> <p>2 were very secretive and very -- gave you no</p> <p>3 disclosure, no transparency, no questions asked.</p> <p>4 Those types of funds were -- were sort</p> <p>5 of replaced by the fund to funds, the feeder</p> <p>6 funds, as they're called, and these other big</p> <p>7 macro funds, which basically started doing</p> <p>8 business with institutional business, like</p> <p>9 pension funds and so on, which were required to</p> <p>10 get this information.</p> <p>11 So the industry -- the original -- as I</p> <p>12 said, the original hedge fund industry was by</p> <p>13 sophisticated people, who were Europeans mostly,</p> <p>14 who were perfectly happy to not have you ask</p> <p>15 them where their money was from, whether it was</p> <p>16 legitimate money, whether it was tax money or</p> <p>17 whatever.</p> <p>18 Because you have to understand that</p> <p>19 you're very hard pressed to find a European</p> <p>20 investor that doesn't have a Swiss bank account</p> <p>21 or money somewhere offshore for perfectly good</p> <p>22 reasons.</p> <p>23 They -- you know, when you -- when</p> <p>24 your -- when your country is taken over and your</p> <p>25 industries are nationalized or your country goes</p>
131	<p>1 A. Everyone asked me that. Everyone would</p> <p>2 do that, and --</p> <p>3 Q. Did they press you to get answers to the</p> <p>4 questions you refused to answer --</p> <p>5 MR. REGAN: Objection.</p> <p>6 Q. -- as a result of Bayou?</p> <p>7 MR. REGAN: Objection.</p> <p>8 THE WITNESS: Yeah. I mean, people --</p> <p>9 people would ask me these questions. I would</p> <p>10 say, I'm not going to do it, or I would answer</p> <p>11 them to the best of my ability, which sometimes</p> <p>12 made sense, sometimes didn't make sense.</p> <p>13 But with enough -- there was always enough</p> <p>14 truth to it, you know, that it was okay. Plus</p> <p>15 the fact that, you know, I had this reputation</p> <p>16 of being secretive and independent.</p> <p>17 BY MR. BLEICHMAR:</p> <p>18 Q. And why didn't sometimes the explanations</p> <p>19 make sense?</p> <p>20 A. Because I was -- I was the exception,</p> <p>21 rather than the rule, as far as giving this</p> <p>22 information out.</p> <p>23 Q. In what way were you the exception?</p> <p>24 A. Well, the hedge fund business had</p> <p>25 changed over the years. From the handful of</p>	133	<p>1 to war, and you worry about all of a sudden</p> <p>2 everything disappearing, except what you can put</p> <p>3 on your back or carry in your teeth, you</p> <p>4 always -- if you make enough money, you</p> <p>5 immediately take that money, and you put it</p> <p>6 somewhere else.</p> <p>7 So Europeans, that's their culture.</p> <p>8 That's their nature. They don't trust their</p> <p>9 governments, for very good reason. As recently,</p> <p>10 as I said, in 1980, when Mitterrand came into</p> <p>11 France.</p> <p>12 So they don't disclose that. So if</p> <p>13 you -- and every one of them has -- has a bank</p> <p>14 account that is prohibited for them to disclose.</p> <p>15 The bank will not disclose this information,</p> <p>16 which is one of the problems the IRS has today</p> <p>17 with UBS and Credit Suisse and so on.</p> <p>18 So you had a whole breed of investors,</p> <p>19 the original hedge fund investors, that said,</p> <p>20 look, I don't need to know anything. Don't ask</p> <p>21 me about my money, and I'm not asking you about</p> <p>22 yours and so on and so forth. And, I'm a big</p> <p>23 boy, and I'll put my money up and take my</p> <p>24 chances, and that's it.</p> <p>25 That was replaced -- and they wouldn't</p>

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134	<p>1 deal with pension funds or any of those people,  2 because the rules wouldn't allow pension funds  3 to do it.  4 They have to have independent  5 custodians. They have lots of different things.  6 And they have all of these risk managers and due  7 diligence people, and these guys didn't want to  8 be bothered with that.  9 So it became -- people realized there's  10 an opening here, that if -- if -- if these  11 feeder funds can now give you all of this  12 disclosure, they can give you this transparency,  13 then they can capture all of this business that  14 was up to this point not being solicited by  15 anybody in the hedge fund field.  16 So, as a matter of fact, the hedge funds  17 started to retire. Mike Steinhardt left.  18 Julian Robertson said, I'm not -- forget it.  19 I'm not dealing with these characters, because  20 then the average -- then their investors started  21 asking them for this information. They said,  22 I'm not doing it.  23 So you had a whole group of Manuel  24 types, okay, that were not decision makers,  25 other than deciding where to put the money</p>	136	<p>1 Optimal ever did?  2 MR. REGAN: Objection.  3 THE WITNESS: I don't remember.  4 BY MR. BLEICHMAR:  5 Q. Okay. What did the other hedge fund  6 clients do?  7 A. Well, they would -- they would ask me  8 that, you know, with a smile. Like, you know,  9 somebody would say, you know, you're not --  10 you're not a Bayou, they said, which is a hedge  11 fund which blew up. Or, you're not -- are you  12 really doing these trades, or -- you know, and  13 so on and so forth.  14 And sometimes I would say, no, I'm not.  15 They would laugh, and then that would be the end  16 of it. They didn't want to believe it.  17 Q. Did Optimal ever ask you if BMIS had been  18 audited by the SEC or any other regulatory agency?  19 A. Yes, and we were routinely. I used to  20 get two ASD audits a year at a minimum. One was  21 always the financial, and then we -- actually,  22 three of them.  23 And then two of them were market making  24 exams, which concentrated on our -- on our  25 market making buying and selling.</p>
135	<p>1 that -- their primary function was to do due  2 diligence, to find managers and keep the  3 managers happy and to keep their -- their  4 investors happy.  5 And that was the role, and nobody wanted  6 to rock the boat. And the more they rocked the  7 boat, the more problems they had.  8 So, you know, that was -- that was  9 typical of what went on in the business. And I  10 was more of the old school, you know. So --  11 And I used to say to people, look, you  12 know, I don't need this. I was very cavalier.  13 If you want to do business with me, fine. If  14 you won't do business with me, that's also okay.  15 And, to a certain extent, that was  16 like -- you know, the more I said that, the more  17 they'd want to do business with me.  18 Q. Did Optimal ever ask you point blank  19 whether you were running a Ponzi scheme?  20 A. I don't think they -- I don't recall  21 them saying it in those terms, but there was no  22 question that a lot of the hedge fund clients,  23 that's what they worried about. But they  24 worried -- they worried about --  25 Q. But let's talk about, do you remember if</p>	137	<p>1 Then I would get an SEC audit typically  2 every five years, which was standard throughout  3 the industry.  4 Q. And was this audit on the broker-dealer  5 side of the business or on the money management side  6 of the business?  7 A. Well, it was supposed to be on both, but  8 it was clearly because the SEC was not aware of  9 the fact, certainly in the '90s, when it -- by  10 the time I started doing not doing the business,  11 then the SEC was not aware of -- or nor were the  12 NASD of the -- well --  13 Q. They were not aware of what? I'm sorry.  14 A. They were not aware of the volumes of  15 business that I was doing with hedge funds or  16 clients. That became -- showed up on their  17 radar screen, as far as I know, like in 2000.  18 The -- but we were doing so much other  19 business that it wouldn't have been shocking for  20 them -- and maybe they did know. I don't know.  21 Look, now, in -- you know, I keep  22 reading that there were people, whistle blowers  23 and that. There were inquiries and letters and  24 all of this stuff that went on at the SEC, which  25 they never followed up on. So I really don't</p>

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138	<p>1 know what they knew or not.</p> <p>2 I know for a fact that in -- 2002 was</p> <p>3 the first time that I received a direct inquiry</p> <p>4 from the SEC in Washington as to what my hedge</p> <p>5 fund business was. And that was part of a hedge</p> <p>6 fund sweep that they were doing with hedge</p> <p>7 funds.</p> <p>8 They -- they -- part of that sweep</p> <p>9 involved Fairfield, which was a big -- my</p> <p>10 biggest client. And during that -- that sweep,</p> <p>11 Lori Richards and her department, which was</p> <p>12 the -- she was the head of all -- of compliance</p> <p>13 and inspections at the SEC, became aware of the</p> <p>14 fact that I was -- she thought I had a hedge</p> <p>15 fund.</p> <p>16 So I received a phone call from her,</p> <p>17 saying, Bernie, are you -- do you have a hedge</p> <p>18 fund?</p> <p>19 And I said, no. I do not have a hedge</p> <p>20 fund.</p> <p>21 And she said, because I'm being told</p> <p>22 that you have a big hedge fund.</p> <p>23 I said, no. I execute trades for hedge</p> <p>24 funds. I have -- and I explained to her, I have</p> <p>25 a model, you know, that I use. I do trades for</p>	140	<p>1 information. So we shipped down to</p> <p>2 Washington -- I don't know how many trans files.</p> <p>3 Probably 50 trans files of documents, trading</p> <p>4 runs and so on.</p> <p>5 And it all had to do with my market</p> <p>6 making business at that time.</p> <p>7 Q. Not your money management?</p> <p>8 A. Well, it did both, but I mean the volume</p> <p>9 of trading was on my market making side. So</p> <p>10 when she looked at -- when she looked at this</p> <p>11 information, it was obvious that I wasn't</p> <p>12 running in front of any orders, because we</p> <p>13 weren't.</p> <p>14 You know, first of all, we weren't</p> <p>15 executing the trades for the hedge fund clients</p> <p>16 at this time. It was 2002. So the trading that</p> <p>17 she saw was part of my market making business.</p> <p>18 So she looked at that.</p> <p>19 And even when -- when I was doing the</p> <p>20 legitimate business, we never ran ahead, because</p> <p>21 we -- we operated from a different floor,</p> <p>22 different traders and so on in the systems.</p> <p>23 So, you know, up until '92, when we were</p> <p>24 doing this type of trading, it was perfectly</p> <p>25 legitimate trading. No front running or</p>
139	<p>1 hedge funds and so on and so forth.</p> <p>2 And she said, oh, I didn't think so. So</p> <p>3 she said, well, all right. You know, we may</p> <p>4 need some more -- we may have some more</p> <p>5 questions for you after the first of the year,</p> <p>6 because we're -- we noticed your name come up on</p> <p>7 some of these hedge fund sweeps that we're</p> <p>8 doing, and we just want to try and understand</p> <p>9 what it was.</p> <p>10 And it related to this whether or not I</p> <p>11 was being an advisor to a hedge fund and so on.</p> <p>12 So after the first of the year, she sent me a</p> <p>13 list of all sorts of information she wanted,</p> <p>14 documents as to who are my hedge fund clients at</p> <p>15 that time, what the strategy was, because she</p> <p>16 was -- they were concerned about front running.</p> <p>17 Front running is a practice where market</p> <p>18 makers or proprietary traders become aware of a</p> <p>19 large order that an institutional client or a</p> <p>20 hedge fund has, and they run ahead of that</p> <p>21 order, which is illegal to do that.</p> <p>22 So she was concerned that maybe we were</p> <p>23 front running, which she couldn't believe,</p> <p>24 because of my reputation with her.</p> <p>25 But I said, fine. I'll send you the</p>	141	<p>1 anything.</p> <p>2 So they didn't go back that far anyhow.</p> <p>3 They only wanted -- they went back, I guess,</p> <p>4 maybe a year or two. So they saw that. It was</p> <p>5 fine, and nothing came of it. That was the end</p> <p>6 of it.</p> <p>7 It was at a later date, at a subsequent</p> <p>8 investigation involving another group of hedge</p> <p>9 funds, that the investment advisor issue came</p> <p>10 up. And that was, as I say, in 2000 -- 2006.</p> <p>11 So there was -- all broker-dealers were</p> <p>12 involved in inspections, and we -- in 50 years I</p> <p>13 think we've had two violations that showed up in</p> <p>14 inspections, and they were minor things. From a</p> <p>15 fine of \$500 for volume reporting. Which was</p> <p>16 probably one of the cleanest records that</p> <p>17 existed in Wall Street.</p> <p>18 Q. Was it your impression that you were able</p> <p>19 to conceal the illegitimate business from the SEC in</p> <p>20 part by putting forward the broker-dealer side of</p> <p>21 the business?</p> <p>22 A. No. I think that the broker-dealer side</p> <p>23 of the business most people would understand was</p> <p>24 separate. We -- we made that very clear to the</p> <p>25 client. That was a question that every -- every</p>

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142	<p>1 hedge fund asked us.</p> <p>2 They wanted to know, because the -- the</p> <p>3 original stories going around, Switzerland</p> <p>4 particularly, was the reason Bernie can do these</p> <p>5 trades was because he has this huge amount of</p> <p>6 order flow available from the market making</p> <p>7 side, and he must be front running the orders.</p> <p>8 That was it.</p> <p>9 Q. When you say, "Switzerland," what are you</p> <p>10 referring to?</p> <p>11 A. Because the hedge fund -- the Swiss</p> <p>12 hedge funds were the ones that started this</p> <p>13 rumor. Now --</p> <p>14 Q. By that are you including Optimal in that?</p> <p>15 A. All of them. I mean, you know, I would</p> <p>16 say -- look, you have to understand, the Swiss,</p> <p>17 by their very nature, are always very</p> <p>18 suspicious, okay, because everything they do is</p> <p>19 secretive and deceptive, you know.</p> <p>20 The -- what -- to a certain extent they</p> <p>21 loved that theory, you know. This -- because</p> <p>22 this front running was not illegal in</p> <p>23 Switzerland. So this now -- and I -- I saw -- I</p> <p>24 saw humor in this.</p> <p>25 It was like, ah, now I know how you can</p>	144	<p>1 would tell -- eventually they would get to their</p> <p>2 general counsel, and would say, we found out how</p> <p>3 Bernie is able to do this. He's front running</p> <p>4 all of these orders.</p> <p>5 The general counsel, you know, would</p> <p>6 hopefully say, that's illegal. He can't do</p> <p>7 that.</p> <p>8 So then they -- they had this -- this</p> <p>9 tug of war. Well, do we -- what -- what happens</p> <p>10 if the SEC shuts him down, because he's doing</p> <p>11 this illegal stuff?</p> <p>12 And some of them -- I read this</p> <p>13 subsequently in some of the e-mails. They said,</p> <p>14 all right. He shuts them down. He'll give us</p> <p>15 the money back.</p> <p>16 This is better than not doing the trades</p> <p>17 in their mind, you know. You know, they'll say,</p> <p>18 you can't do this anymore, return the money, and</p> <p>19 that's the end of it.</p> <p>20 All right. So I would say, I -- you</p> <p>21 know, they all -- almost every fund would, you</p> <p>22 know, have another meeting with me and say,</p> <p>23 well, okay. So you're front running, or, are</p> <p>24 you front running?</p> <p>25 And I'd say, I'm not front running. I'd</p>
143	<p>1 do this. Before we couldn't figure out how you</p> <p>2 could do things that nobody else could do, you</p> <p>3 know.</p> <p>4 Why can't Merrill Lynch do this, and</p> <p>5 this one do this, and this one do this? But</p> <p>6 Bernie Madoff has more business than anybody,</p> <p>7 because he has all of this market making</p> <p>8 business, which gets him great information, and</p> <p>9 so he must be front running.</p> <p>10 Q. Did that make sense to you?</p> <p>11 A. It did, except it wasn't true. And it</p> <p>12 was illegal in the United States. It wasn't</p> <p>13 illegal in Switzerland.</p> <p>14 There was -- to them it was, you know,</p> <p>15 like having a Swiss bank account. It was, you</p> <p>16 know, you know, of course -- of course, we -- we</p> <p>17 front run. Of course, we have, you know, dirty</p> <p>18 money.</p> <p>19 So this was like -- this -- this was --</p> <p>20 they finally -- you know, the light bulbs went</p> <p>21 off, and they said, God, this is okay. We don't</p> <p>22 mind dealing with a guy who is doing it. Now it</p> <p>23 makes sense.</p> <p>24 And they -- but there was some that</p> <p>25 said, well, this is illegal. The smarter ones</p>	145	<p>1 say, I can't. It's illegal.</p> <p>2 And they're saying, well, how could a</p> <p>3 market maker be doing both businesses? That was</p> <p>4 their big thing. The Swiss, you know, that was</p> <p>5 their big thing. The market maker can't be.</p> <p>6 And I would say -- and I guess the</p> <p>7 spearheading of that was Thema and, you know,</p> <p>8 Kingate. They -- they were the ones who were</p> <p>9 focusing in on that, and probably Optimal as</p> <p>10 well.</p> <p>11 And I said, look, there is nothing wrong</p> <p>12 with a market maker, you know, running an</p> <p>13 investment management business, which they were</p> <p>14 convinced we couldn't do.</p> <p>15 And I said, don't be ridiculous. I</p> <p>16 said, every major bank and brokerage firm has</p> <p>17 money management and also has market making</p> <p>18 operations and proprietary operations. And as</p> <p>19 long as they keep them separate and they have</p> <p>20 Chinese wall procedures, they're fine.</p> <p>21 Well, most of them, you know, had the</p> <p>22 ability to check this out by calling the</p> <p>23 regulators or their own general counsels, and,</p> <p>24 yeah, that's right. They can do that. Then</p> <p>25 they -- Goldman had it. Merrill Lynch had it,</p>

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146	<p>1 and everybody else had it.</p> <p>2 So, now, okay. Bernie, as long as he</p> <p>3 does -- follows the rules, it's okay. But he</p> <p>4 still has all of this order flow. So he must be</p> <p>5 getting these great signals.</p> <p>6 And we would say, yeah, the market</p> <p>7 making gives us the signals, you know, about the</p> <p>8 market in general, but that's perfectly legal.</p> <p>9 You just can't buy against individual orders.</p> <p>10 So then all of a sudden there was this</p> <p>11 merger mania going on. Everybody woke up and</p> <p>12 said, the market making business was a great</p> <p>13 business.</p> <p>14 Because you have to understand that the</p> <p>15 average return on capital in the market making</p> <p>16 and special business for most of the years in</p> <p>17 the industry was 36 percent return on capital.</p> <p>18 That's what people made.</p> <p>19 It was a gold mine. Us included. You</p> <p>20 know, we never -- our returns were never that</p> <p>21 high, because we basically were involved in</p> <p>22 arbitrage and hedging, which was less risky, but</p> <p>23 we certainly always made in excess of 20, you</p> <p>24 know, 25 percent return on capital.</p> <p>25 So this became a very attractive</p>	148	<p>1 that time, because of decimalization, was over,</p> <p>2 but nobody realized that. It was as obvious as</p> <p>3 the nose on your face.</p> <p>4 And it was certainly obvious to us,</p> <p>5 because we were involved in decimalization at</p> <p>6 the very beginning. We knew that the spreads</p> <p>7 were going to close and be different. And --</p> <p>8 So my sons, who ran the market making</p> <p>9 business, said, let's sell. My brother refused</p> <p>10 to, because that was his baby. He didn't want</p> <p>11 to sell that.</p> <p>12 I didn't want to sell, because it was</p> <p>13 like the Emperor's New Clothes. How was I going</p> <p>14 to be able to do the due diligence?</p> <p>15 And in spite of the fact that Morgan --</p> <p>16 that Sandy Weil and Bart Rubin, from Smith</p> <p>17 Barney, said, listen, how can you turn down two,</p> <p>18 three billion? Just meet with us at least, you</p> <p>19 know.</p> <p>20 I knew that I couldn't open my books up</p> <p>21 to them. As much as they liked me, as nice a</p> <p>22 reputation as I had, they weren't going to give</p> <p>23 me a check for two or three billion dollars.</p> <p>24 Q. Why couldn't you open up your books to</p> <p>25 them?</p>
147	<p>1 business. And I think that probably started in</p> <p>2 2002, there was this merger frenzy. And --</p> <p>3 So all of a sudden the hedge funds that</p> <p>4 were suspicious about this front running or this</p> <p>5 issue of having a market making, which was a</p> <p>6 conflict of interest with the money management,</p> <p>7 said, wait a minute. This is obviously okay.</p> <p>8 Because Goldman was buying Spear Leeds,</p> <p>9 which was one of my biggest competitors, you</p> <p>10 know. Merrill Lynch bought Herzog, another big</p> <p>11 competitor.</p> <p>12 And people were trying to buy us. Smith</p> <p>13 Barney and Morgan Stanley both were offering us,</p> <p>14 you know, two to three billion dollars to buy</p> <p>15 our -- our operation.</p> <p>16 Part of it was they thought we also had</p> <p>17 this money management side, but they -- the</p> <p>18 market making side was what they were interested</p> <p>19 in.</p> <p>20 Now, I couldn't -- my sons -- that</p> <p>21 became a big issue with my sons and brother,</p> <p>22 because my sons wanted me to sell. They -- you</p> <p>23 know, they said, two, three billion dollars?</p> <p>24 Let's take it and go home, you know.</p> <p>25 Because the market making business at</p>	149	<p>1 A. Because they would have -- they would</p> <p>2 have seen that I wasn't doing the trades and the</p> <p>3 money management side of the business.</p> <p>4 Q. And why would they have been able to see</p> <p>5 that, as opposed to an investor in a -- from a hedge</p> <p>6 fund?</p> <p>7 A. Well, they would have sent a team of</p> <p>8 auditors in there that knew what they were</p> <p>9 doing, and they would have -- you know, they</p> <p>10 would have wanted to see the -- the business on</p> <p>11 the market -- on not only the market making,</p> <p>12 because one of the big attractions was also the</p> <p>13 investment management side. So --</p> <p>14 Because they -- not only that, but they</p> <p>15 said to me was, look, give back all of your</p> <p>16 money from hedge funds. You know, we'll give</p> <p>17 you all of the money you need. You don't need</p> <p>18 money from them.</p> <p>19 Get rid of these guys. They're all a</p> <p>20 pain in the ass; right? You always say you</p> <p>21 don't like hedge funds. Return all of the</p> <p>22 money.</p> <p>23 Merrill Lynch will do -- because Merrill</p> <p>24 Lynch was already to the point of also hammering</p> <p>25 on my door to give me money to manage as well.</p>

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150	<p>1 They all had internal hedge funds.</p> <p>2 So there was this -- I couldn't admit to</p> <p>3 my sons or my brother that I had this fraud</p> <p>4 going on. It was a very uncomfortable situation</p> <p>5 for me.</p> <p>6 And I just said, look, I'm not selling</p> <p>7 out to anybody. I don't want partners. I never</p> <p>8 had any partners. I'm just not doing it. And</p> <p>9 that was it.</p> <p>10 And that led to a lot of arguments</p> <p>11 internally from my sons, who said -- because</p> <p>12 they couldn't figure it out. They said -- as a</p> <p>13 matter of fact, their response was, look, Dad,</p> <p>14 you're, you know, 70 years old.</p> <p>15 You love your boat. Go on your boat.</p> <p>16 Cruise the Mediterranean with Mom. We'll</p> <p>17 manage -- you know, we'll each take a billion</p> <p>18 dollars, and we'll manage it privately</p> <p>19 ourselves.</p> <p>20 Don't deal with customers. Don't deal</p> <p>21 with hedge funds. Don't deal with nothing, you</p> <p>22 know.</p> <p>23 That was -- and it made sense, you know.</p> <p>24 My wife didn't want to side between one</p> <p>25 or the other.</p>	152	<p>1 A. Friehling &amp; Horowitz, which was</p> <p>2 basically David Friehling.</p> <p>3 Q. And they ran an audit at BMIS; correct?</p> <p>4 A. Yeah, but they had no idea -- they ran</p> <p>5 BMIS, and they also ran an audit of the</p> <p>6 investment management side. But they also</p> <p>7 never -- never followed through with the</p> <p>8 depository.</p> <p>9 There's a -- look, there's a basic</p> <p>10 auditing practice with any audit, regardless of</p> <p>11 whether you're making, you know, basketballs or</p> <p>12 whether you're buying stock.</p> <p>13 When you do an audit, you do an</p> <p>14 inventory audit, and you check the inventory.</p> <p>15 Whether it means counting bolts of clothing on a</p> <p>16 shelf or basketballs or whether it's securities,</p> <p>17 getting an independent audit.</p> <p>18 If the securities aren't physically in</p> <p>19 the location, in your vault, they have to be</p> <p>20 somewhere, and you would check and get that.</p> <p>21 Q. Did Friehling &amp; Horowitz not do an</p> <p>22 inventory?</p> <p>23 A. They didn't do it. They failed to do it</p> <p>24 also, because they had -- they looked at -- we</p> <p>25 had -- by that time we had records of --</p>
151	<p>1 And I just said, I'm not doing it. And,</p> <p>2 again, you know, my personality was such that</p> <p>3 everybody accepted that I was a pain in the ass</p> <p>4 and hard to deal with. And that was that.</p> <p>5 So I'm not sure that I -- I remember the</p> <p>6 question you originally asked me.</p> <p>7 Q. Well, let me ask this question: Where --</p> <p>8 where would the auditors or the team of auditors</p> <p>9 that you said, for example, Smith Barney, would have</p> <p>10 sent in found in your books that, you know, you were</p> <p>11 running a fraud?</p> <p>12 A. They would see that I don't have the</p> <p>13 securities. I mean, it wasn't that complicated.</p> <p>14 Q. Where would they see that?</p> <p>15 A. Well, they typically would have, you</p> <p>16 know, wanted to confirm with the DTC, if you're</p> <p>17 doing a full-blown audit. The same thing the</p> <p>18 SEC failed to do or the NASD.</p> <p>19 They never -- they never -- even when I</p> <p>20 asked -- when they asked me in 2006, where are</p> <p>21 these securities held? By then they had already</p> <p>22 been suspicious, and they had gotten some tips</p> <p>23 from people that I was running a Ponzi scheme.</p> <p>24 Q. And who were -- who were the auditors at</p> <p>25 BMIS?</p>	153	<p>1 falsified records of the depository.</p> <p>2 It's hard for me to acknowledge all of</p> <p>3 this now, but it doesn't matter.</p> <p>4 Q. So Friehling &amp; Horowitz never went to DTC</p> <p>5 independently and --</p> <p>6 A. No.</p> <p>7 Q. -- and cross-referenced the records you</p> <p>8 gave them?</p> <p>9 A. Which is why -- which is why they have a</p> <p>10 problem. Yes. They never -- they never did an</p> <p>11 independent audit with DTC.</p> <p>12 Q. Do you have an understanding as to why they</p> <p>13 didn't do that?</p> <p>14 A. There was nothing -- there was</p> <p>15 nothing -- they were never told not to do it.</p> <p>16 It was -- they believed when they looked at our</p> <p>17 stock record it showed it at DTC.</p> <p>18 And at some point we had actually</p> <p>19 reproduced DTC information. And a real audit,</p> <p>20 an important, thorough audit would have been to</p> <p>21 confirm directly.</p> <p>22 Which, as you're seeing now in this</p> <p>23 latest thing that happened with this Peregrine</p> <p>24 Capital, with the clearing corporation, nobody</p> <p>25 did that. Nobody -- nobody got an audit.</p>

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154	<p>1 He -- he created his own statements, and</p> <p>2 they sent to -- the accountant sent them to a</p> <p>3 post office box number.</p> <p>4 You really couldn't do that with DTC,</p> <p>5 because it was just impractical. But people did</p> <p>6 that with Bayou. They did that with Bear</p> <p>7 Stearns. They reproduced Bear Stearns'</p> <p>8 statements.</p> <p>9 People have been doing that since the</p> <p>10 beginning of time. I mean --</p> <p>11 Q. Falsifying records?</p> <p>12 A. Yeah. I mean it happens with -- with</p> <p>13 the biggest banks, you know. With the one with</p> <p>14 Barings, and it was the same thing.</p> <p>15 These guys get involved -- they get</p> <p>16 somebody in the back office that they go into</p> <p>17 cahoots with, and they produce records. I mean,</p> <p>18 you know, it's -- it's -- it's the way it is.</p> <p>19 Q. Are you familiar with the term big four</p> <p>20 when you refer to accounting firms?</p> <p>21 A. Yeah.</p> <p>22 Q. And who are the big four?</p> <p>23 A. That would basically be Coopers and --</p> <p>24 it used to be big five before Arthur Andersen</p> <p>25 was put out of business, but it was -- you know,</p>	156	<p>1 books.</p> <p>2 I had checked with my friends, who were</p> <p>3 officers at -- the treasurer of Bear Stearns.</p> <p>4 They said, are you kidding me? They said, we</p> <p>5 would never let another -- if we have a client</p> <p>6 that insists upon that, we'd say, close your</p> <p>7 account.</p> <p>8 Now, they had the advantage that they</p> <p>9 weren't using Friehling &amp; Horowitz. Those firms</p> <p>10 were using one of the big four firms. So they</p> <p>11 had enough credibility that they didn't need to</p> <p>12 be checked.</p> <p>13 But since I didn't have that, HSBC said,</p> <p>14 well, you know, this is what we require. So my</p> <p>15 back was to the wall on that. And I said, okay.</p> <p>16 Send them in.</p> <p>17 So HSBC came in twice over a period of</p> <p>18 two years and spent a couple of weeks each time,</p> <p>19 doing a complete audit of the investment</p> <p>20 advisory business.</p> <p>21 Q. Did that audit independently confirm with</p> <p>22 DTC the existence of the securities?</p> <p>23 A. No.</p> <p>24 Q. And how did it not -- how did they not do</p> <p>25 that?</p>
155	<p>1 PricewaterhouseCoopers was one. Ernst &amp; Young</p> <p>2 was another one. Deloitte was another one. I</p> <p>3 don't remember the other three.</p> <p>4 Q. Did any of the big four ever come and</p> <p>5 conduct an audit of BMIS?</p> <p>6 A. Yeah. HSBC sent in -- that was the</p> <p>7 auditor for the new audit in London of me.</p> <p>8 Q. KPMG?</p> <p>9 A. KPMG. KPMG was the other one, the</p> <p>10 fourth audit. Yeah, KP -- I got a call from</p> <p>11 HSBC, who was the custodian for a lot of the</p> <p>12 funds, saying that part of their due diligence</p> <p>13 was they're required to do an independent audit,</p> <p>14 which, quite frankly, was not true.</p> <p>15 It was unusual. I checked with other</p> <p>16 firms, like Bear Stearns and Merrill Lynch, and</p> <p>17 said they would never let another auditing firm</p> <p>18 come in and audit their books. They said --</p> <p>19 Q. When you said, "another auditing firm," you</p> <p>20 mean --</p> <p>21 A. Other than their own.</p> <p>22 Q. -- a firm that is not their own; right?</p> <p>23 A. They would never -- they would never</p> <p>24 have an -- an outside auditing firm come in,</p> <p>25 other than their own auditor, to audit their</p>	157	<p>1 A. Because they couldn't do that without my</p> <p>2 permission. DTC wouldn't do it.</p> <p>3 Q. And did you refuse to give them your</p> <p>4 permission?</p> <p>5 A. They never asked.</p> <p>6 Q. Why was your back to the wall?</p> <p>7 A. Well, because they made it clear that</p> <p>8 they had no choice, but they -- and they had too</p> <p>9 many clients. So if they all of a sudden said,</p> <p>10 look, you know, we're going to have to -- they</p> <p>11 represented, you know, Thema or Kingate. They</p> <p>12 had a lot of clients. So I had no choice but to</p> <p>13 let them come in.</p> <p>14 Q. And they did an audit of the investment --</p> <p>15 the money management side of the business?</p> <p>16 A. Yeah. They did a complete audit for two</p> <p>17 weeks. They did everything, and they -- they</p> <p>18 confirmed the custody issue by reviewing the</p> <p>19 stock record.</p> <p>20 And I believe the second time they came</p> <p>21 they looked at -- they had -- we had produced</p> <p>22 DTC records. Meaning people in my office.</p> <p>23 Frank Dipascali produced DTC records for them.</p> <p>24 But they never did what they should have</p> <p>25 done, which was directly contact DTC. Which</p>



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158	<p>1 they could have done, if I gave them permission.</p> <p>2 Q. But they never asked?</p> <p>3 A. They never asked to do that.</p> <p>4 Q. Did any -- did anybody ever ask you to give</p> <p>5 them permission to independently confirm with DTC?</p> <p>6 A. No.</p> <p>7 Q. Nobody ever did?</p> <p>8 A. No.</p> <p>9 Q. Optimal never asked you that?</p> <p>10 A. No.</p> <p>11 Q. Let me --</p> <p>12 MR. REGAN: Javier, let's give --</p> <p>13 MR. BLEICHMAR: Yeah.</p> <p>14 MR. REGAN: Can we just take a quick break?</p> <p>15 MR. BLEICHMAR: Yeah. We can take a quick</p> <p>16 break.</p> <p>17 MR. REGAN: Yeah, stretch and --</p> <p>18 MR. BLEICHMAR: Let's go off the record.</p> <p>19 (RECESS FROM 11:41 A.M. TO 11:55 P.M.)</p> <p>20 BY MR. BLEICHMAR:</p> <p>21 Q. Let me show you an article -- I'm not going</p> <p>22 to mark as an exhibit -- that was printed in the</p> <p>23 New York Times.</p> <p>24 MR. REGAN: Did you say you're not going to</p> <p>25 mark this?</p>	160	<p>1 she interviewed me a couple of times.</p> <p>2 Q. She interviewed you here?</p> <p>3 A. Here. Yes.</p> <p>4 Q. So after 2008?</p> <p>5 A. Yeah.</p> <p>6 Q. I'm going to go to the third paragraph from</p> <p>7 the top. See where it says, "but during a private</p> <p>8 two-hour interview"? It's the third paragraph.</p> <p>9 A. Right.</p> <p>10 Q. Yeah.</p> <p>11 And on the second line it says, quote, "He</p> <p>12 asserted that unidentified banks and hedge funds</p> <p>13 were somehow complicit in his elaborate fraud."</p> <p>14 Do you -- let me just first establish, do</p> <p>15 you remember giving that interview and saying that?</p> <p>16 A. Yes, I do.</p> <p>17 Q. Okay. And what did you mean by</p> <p>18 unidentified banks and hedge funds were somehow</p> <p>19 complicit?</p> <p>20 A. Well, I felt that they -- they were --</p> <p>21 they lacked to do the proper due diligence that</p> <p>22 they should have done, you know, to -- to</p> <p>23 discover whether or not there was a fraud</p> <p>24 involved.</p> <p>25 And basically it was all of the things</p>
159	<p>1 MR. BLEICHMAR: I'm not going to mark it as</p> <p>2 an exhibit.</p> <p>3 MR. REGAN: Okay.</p> <p>4 MR. BLEICHMAR: I'm just going to use it to</p> <p>5 refresh his recollection.</p> <p>6 BY MR. BLEICHMAR:</p> <p>7 Q. That is -- it states that it's February 15,</p> <p>8 2011, "From Prison, Madoff Says, Banks Had to Know</p> <p>9 of Fraud," by Diana Henriques. Did you give an</p> <p>10 interview taken by Diana Henriques?</p> <p>11 A. Yes.</p> <p>12 Q. And does -- did you read this article at</p> <p>13 the time?</p> <p>14 A. She wrote --</p> <p>15 MR. REGAN: I'm sorry. Did you say, "did</p> <p>16 you read this article" --</p> <p>17 MR. BLEICHMAR: Yeah.</p> <p>18 MR. REGAN: -- "at the time"?</p> <p>19 THE WITNESS: Yeah, yeah. I -- yeah. I --</p> <p>20 I read this. I read it in her book, I guess.</p> <p>21 BY MR. BLEICHMAR:</p> <p>22 Q. And just, very briefly, who is Diana</p> <p>23 Henriques?</p> <p>24 A. She's a -- was a writer for the New York</p> <p>25 Times, and she wrote a book about my case, and</p>	161	<p>1 that I've discussed, you know, here, that now --</p> <p>2 you know, whether or not -- I guess this sort of</p> <p>3 relates to what, you know, should have known, as</p> <p>4 opposed to actually knowing.</p> <p>5 I have no way of knowing that a bank</p> <p>6 actually knew that I was committing a fraud.</p> <p>7 You know, no one asked me, are you committing a</p> <p>8 fraud? And I said, yes.</p> <p>9 And I thought that they believed me, you</p> <p>10 know. If I said, yes, it was, you know, in an</p> <p>11 offhanded way, as a joke, you know. So --</p> <p>12 But I felt that -- that certain of these</p> <p>13 people just -- you know, had they been doing the</p> <p>14 job properly, would have -- should have known</p> <p>15 that something was wrong.</p> <p>16 Q. Would you include Optimal in -- in that --</p> <p>17 A. Yeah.</p> <p>18 Q. -- subset of people?</p> <p>19 A. Uh-huh.</p> <p>20 Q. Is that a, yes?</p> <p>21 A. Yes.</p> <p>22 MR. REGAN: Objection.</p> <p>23 BY MR. BLEICHMAR:</p> <p>24 Q. Let me move on to what's the sixth</p> <p>25 paragraph. The one that starts, "In many ways,</p>

162	<p>1 however." Do you see that?</p> <p>2 It says -- the second sentence in that</p> <p>3 paragraph says, quote, "He spoke with great</p> <p>4 intensity and fluency about his dealings with</p> <p>5 various banks and hedge funds, pointing to their</p> <p>6 willful blindness and their failure to examine</p> <p>7 discrepancies between his regulatory filings and</p> <p>8 other information available to them," end quote.</p> <p>9 Do you see that?</p> <p>10 A. Okay. Yeah.</p> <p>11 Q. Did you say that?</p> <p>12 A. Yes.</p> <p>13 Q. And what did you mean by that?</p> <p>14 A. Well, the regulatory filings -- there</p> <p>15 were -- there were two regulatory filings that</p> <p>16 were important.</p> <p>17 First of all, there was what they</p> <p>18 call -- I can't remember. Investment managers</p> <p>19 are required to file quarterly the assets that</p> <p>20 they have.</p> <p>21 Q. Is that the ATV form?</p> <p>22 A. No. That they have under management.</p> <p>23 It -- it meant -- it's position reporting.</p> <p>24 Q. 13-F?</p> <p>25 A. 13-F. Right. 13-F filings, which</p>	164	<p>1 fund, that I'm aware of, had that strategy.</p> <p>2 But, by the same token, there were very</p> <p>3 few other hedge funds that did what we did. You</p> <p>4 know, that used this particular strategy. And</p> <p>5 there was some -- there was some confusion as to</p> <p>6 what you were required to report.</p> <p>7 I can't remember what the confusion was.</p> <p>8 But as a market maker you -- there were certain</p> <p>9 exemptions, but we clearly would not be -- I</p> <p>10 don't believe that we would have been exempt.</p> <p>11 So that was one thing that, to me, was</p> <p>12 somewhat unusual.</p> <p>13 Again, you know, it depends upon -- you</p> <p>14 sort of have to -- in my mind I felt, as a</p> <p>15 matter of what -- when you say, "willful</p> <p>16 blindness," people believe what they want to</p> <p>17 believe.</p> <p>18 And if you don't connect the dots --</p> <p>19 look, I always had a theory that I used to</p> <p>20 say -- and it's not only my theory. If you</p> <p>21 don't understand a strategy or you don't</p> <p>22 understand a business, you don't go into it.</p> <p>23 Because there is nothing that</p> <p>24 complicated about the stockmarket. In spite of</p> <p>25 the fact that everybody tries to make it seem as</p>
163	<p>1 disclose the positions that you have.</p> <p>2 Now, we, in order to conceal that --</p> <p>3 well, it wasn't in order to conceal that. I</p> <p>4 shouldn't -- I should not say that.</p> <p>5 The -- the strategy that we employed</p> <p>6 always went into treasuries at the end of a</p> <p>7 quarter. That was part of the strategy, because</p> <p>8 the options were usually 90-day options.</p> <p>9 And most of the hedge funds liked the</p> <p>10 idea that we would be liquid at the end of a</p> <p>11 particular quarter. It was basically a way of</p> <p>12 showing that there was liquidity in the</p> <p>13 marketplace and so on.</p> <p>14 And that was the way the strategy was</p> <p>15 originally designed, when it was a legitimate</p> <p>16 strategy.</p> <p>17 So even when it became illegitimate, we</p> <p>18 carried that forward. So that because we were</p> <p>19 always in treasuries at the end of a quarter, a</p> <p>20 reporting quarter, there would be no positions</p> <p>21 to -- to report.</p> <p>22 But that was -- that was an unusual</p> <p>23 procedure.</p> <p>24 Q. Why was it unusual?</p> <p>25 A. Well, because probably no other hedge</p>	165	<p>1 though it's very mysterious and very</p> <p>2 complicated, there's no rocket science.</p> <p>3 So if you don't understand something,</p> <p>4 there's a reason why you don't understand</p> <p>5 something, you know.</p> <p>6 Q. Did you feel that the hedge fund investors</p> <p>7 did not understand what you were doing?</p> <p>8 A. I thought they didn't want to</p> <p>9 understand. I thought that was --</p> <p>10 Q. And what --</p> <p>11 A. -- willful blindness.</p> <p>12 Q. What gave you that impression?</p> <p>13 A. Because they never -- they never really</p> <p>14 objected. There was -- it was always sort of a</p> <p>15 passive, you know, well, I wish you would tell</p> <p>16 me this, but, okay. You're not going to.</p> <p>17 Q. And you're including Optimal in this</p> <p>18 subset?</p> <p>19 A. Yeah.</p> <p>20 Q. Moving on to the paragraph below, which</p> <p>21 says, quote, "They had to know," end quote,</p> <p>22 "Mr. Madoff said," quote, "but the attitude was sort</p> <p>23 of, if you're doing something wrong, we don't want</p> <p>24 to know," end quote.</p> <p>25 Do you remember saying that?</p>

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166	<p>1 A. Yeah.</p> <p>2 Q. You said that?</p> <p>3 A. Uh-huh.</p> <p>4 Q. And what did you mean by that?</p> <p>5 A. What I just said, that they basically --</p> <p>6 I believe that they couldn't resist the profits</p> <p>7 that were being generated from them.</p> <p>8 They were -- there was the hedge funds.</p> <p>9 It was my own clients, you know. The individual</p> <p>10 clients, the same thing.</p> <p>11 I mean, they just -- it's -- the greed</p> <p>12 overtakes them, and they just -- they just</p> <p>13 didn't want to know.</p> <p>14 Q. And this included Optimal?</p> <p>15 A. This included Optimal.</p> <p>16 MR. BLEICHMAR: Let me switch gears. I'm</p> <p>17 going to mark this as Exhibit 1.</p> <p>18 (PLAINTIFFS' EXHIBIT 1 WAS MARKED FOR</p> <p>19 IDENTIFICATION.)</p> <p>20 BY MR. BLEICHMAR:</p> <p>21 Q. I've marked as Exhibit 1 what is entitled,</p> <p>22 "Board of Directors of Banco Santander, London,</p> <p>23 November 21, 2011."</p> <p>24 Do you see, Mr. Madoff, that there's a</p> <p>25 picture of the board of directors in this page?</p>	168	<p>1 A. That sounds familiar.</p> <p>2 Q. Okay.</p> <p>3 A. I met with her and her husband.</p> <p>4 Q. And when did that happen approximately?</p> <p>5 A. Oh, sometime in 2008, I believe.</p> <p>6 Maybe -- I met with her twice.</p> <p>7 Q. Let's start with the first time. So you</p> <p>8 met with Ana Patricia Botin and her husband?</p> <p>9 A. Uh-huh.</p> <p>10 Q. An how do you know it was her husband?</p> <p>11 A. She told me.</p> <p>12 Q. And do you remember his name?</p> <p>13 A. No.</p> <p>14 Q. If I told you that his name is Guillermo</p> <p>15 Morenes, would that refresh your recollection?</p> <p>16 A. All of these Spanish names sound the</p> <p>17 same to me.</p> <p>18 Q. But you knew it was her husband?</p> <p>19 A. Yeah.</p> <p>20 Q. And when did the first meeting take place</p> <p>21 more or less?</p> <p>22 A. Up in my office. I don't remember the</p> <p>23 timeframe. The first time she came up -- I</p> <p>24 believe the first time she came up she came up</p> <p>25 with -- with him. She came up again once after</p>
167	<p>1 A. Uh-huh.</p> <p>2 Q. Do you see that there is -- there's only</p> <p>3 one woman in that picture?</p> <p>4 A. Yeah.</p> <p>5 Q. Do you recognize who that is?</p> <p>6 A. Yes.</p> <p>7 Q. And who is that?</p> <p>8 A. I believe she's the granddaughter of the</p> <p>9 founder of the bank.</p> <p>10 Q. And what is her name?</p> <p>11 A. Well, I'd have to look at it to tell</p> <p>12 you. I don't remember her name. She --</p> <p>13 Q. Let me ask it a different way. Do you --</p> <p>14 have you ever met with the individual who is in this</p> <p>15 picture?</p> <p>16 A. Yes.</p> <p>17 Q. Okay. And do you remember her name?</p> <p>18 MR. REGAN: Objection. Asked and answered.</p> <p>19 THE WITNESS: No.</p> <p>20 BY MR. BLEICHMAR:</p> <p>21 Q. Okay. Below, it says, "Director, Ms. Ana</p> <p>22 Patricia Botin-Sanz;" do you see that?</p> <p>23 A. Yeah.</p> <p>24 Q. Does that refresh your recollection of</p> <p>25 whether you met with her?</p>	169	<p>1 that herself, though. I believe it was only</p> <p>2 twice.</p> <p>3 Q. And let's just remain focused on the first</p> <p>4 meeting with Ms. Botin and her husband. What</p> <p>5 were -- what was the purpose of that meeting?</p> <p>6 A. She just wanted to meet me, and she</p> <p>7 seemed very knowledgeable. I was very impressed</p> <p>8 with her.</p> <p>9 Not so much knowledgeable necessarily in</p> <p>10 the strategy, but knowledgeable about the bank</p> <p>11 and -- I mean, she had an important position at</p> <p>12 the bank at the time.</p> <p>13 So, you know, I knew she -- she was</p> <p>14 someone of -- of importance and -- you know, and</p> <p>15 she just seemed very sharp and very, you know,</p> <p>16 knowledgeable.</p> <p>17 Q. And was the discussion in English?</p> <p>18 A. Yes. No, she spoke perfect English. So</p> <p>19 did her husband.</p> <p>20 Q. And you said this meeting took place in</p> <p>21 your offices?</p> <p>22 A. Yeah.</p> <p>23 Q. This is your office in the Lipstick</p> <p>24 Building?</p> <p>25 A. Yeah, in my conference room.</p>

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171	<p>1 And we discussed, you know, I guess, the</p> <p>2 strategy. You know, it was awhile ago. So I</p> <p>3 don't remember. We must have discussed the</p> <p>4 strategy and just discussed the market.</p> <p>5 We spent more time discussing the market</p> <p>6 in general and what was going on in the</p> <p>7 industry.</p> <p>8 Q. Anything specifically about the strategy</p> <p>9 that you discussed that you remember?</p> <p>10 A. Nothing unusual, you know. It basically</p> <p>11 would have been sort of the same explanation</p> <p>12 that I give everybody about how the strategy</p> <p>13 worked and what the advantages were, so on.</p> <p>14 Q. And did you say this meeting took place</p> <p>15 approximately in 2008?</p> <p>16 A. I don't know. It might have been --</p> <p>17 there was one meeting that was later, that was</p> <p>18 close to the end. So the first meeting could</p> <p>19 have been 2007. I don't recall.</p> <p>20 Q. Anything else you remember about that --</p> <p>21 the discussion in that meeting?</p> <p>22 A. Nothing unusual.</p> <p>23 Q. Was there any subsequent followup or --</p> <p>24 that arose --</p> <p>25 A. No.</p>	173	<p>1 usually in the South of France and on my own</p> <p>2 boat.</p> <p>3 And I just really didn't want to --</p> <p>4 didn't want to go. So I thanked her, and that</p> <p>5 was it.</p> <p>6 So that -- I remember that was during</p> <p>7 the -- it must have been during the summer,</p> <p>8 during the America's Cup race.</p> <p>9 Q. Why didn't you want to go?</p> <p>10 A. I -- for the most part I really tried</p> <p>11 not to socialize with any of my clients. It</p> <p>12 was -- first of all, it was hard enough for me,</p> <p>13 putting on this sort of charade, you know, when</p> <p>14 I had to. The last thing I wanted to do was --</p> <p>15 was develop a social relationship with them.</p> <p>16 And as much as I would have liked to go</p> <p>17 to the America's Cup race, it was just not</p> <p>18 something that I really would want to do.</p> <p>19 And I -- I didn't do that -- I really</p> <p>20 had no social relationship with any of my</p> <p>21 clients for the same reason.</p> <p>22 Q. Was this invitation to go to Spain to the</p> <p>23 America's Cup?</p> <p>24 A. I believe it was in Spain. Yeah.</p> <p>25 Q. Focusing on the second meeting. You</p>

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174	<p>1 mentioned that it was -- entailed a discussion of</p> <p>2 the banking industry in Spain. Did that meeting --</p> <p>3 did you say it also took place in your offices?</p> <p>4 A. Yeah.</p> <p>5 Q. And was it just the two of you?</p> <p>6 A. Yes.</p> <p>7 Q. And how long did that meeting last?</p> <p>8 A. Probably similar; an hour. That's</p> <p>9 usually how long my meetings would take.</p> <p>10 Q. And how did that meeting, the second</p> <p>11 meeting, come about?</p> <p>12 A. I believe -- again, the same as the</p> <p>13 first. Either she called me or Manuel called me</p> <p>14 or Jonathan Clark called me.</p> <p>15 Q. You didn't -- you didn't use e-mail;</p> <p>16 correct?</p> <p>17 A. No.</p> <p>18 Q. And was there any specific purpose for the</p> <p>19 second meeting with Ms. Botin?</p> <p>20 A. Not that I'm aware of.</p> <p>21 Q. And approximately when did it happen, to</p> <p>22 the best of your recollection?</p> <p>23 A. It was sometime in 2008.</p> <p>24 Q. Do you know if it was in the -- in the</p> <p>25 summer of 2008?</p>	176	<p>1 didn't really say that much. He was pretty much</p> <p>2 in the background.</p> <p>3 He was -- it was clearly -- she was, you</p> <p>4 know -- she was sort of in charge of -- I mean,</p> <p>5 she would -- you know, I don't know that he -- I</p> <p>6 don't recall that he was related to the bank in</p> <p>7 any way or Optimal in any way.</p> <p>8 So he was sort of there with her, as</p> <p>9 they were both in New York at the same time. He</p> <p>10 wanted to meet me as well, but it wasn't any --</p> <p>11 he didn't solicit doing business with me</p> <p>12 directly or anything else like that.</p> <p>13 So he seemed, you know, very -- you</p> <p>14 know, an elegant guy and intelligent and very</p> <p>15 polite.</p> <p>16 Q. Did Manuel Echeverria call you after the</p> <p>17 meeting and ask you what had happened at the</p> <p>18 meeting?</p> <p>19 A. He might have, you know. He might have,</p> <p>20 you know. I mean, typically he would -- he --</p> <p>21 he would, you know, stay in touch with me</p> <p>22 periodically and tell me that the meeting went</p> <p>23 well or didn't go -- I mean, it never didn't go</p> <p>24 well.</p> <p>25 So he would usually call me up and thank</p>
175	<p>1 A. No. I can't remember.</p> <p>2 Q. Do you remember if it was after -- or</p> <p>3 before Bear Stearns collapsed?</p> <p>4 A. I don't -- I don't recall.</p> <p>5 Q. Anything else you remember about the second</p> <p>6 meeting with Ms. Botin?</p> <p>7 A. No.</p> <p>8 Q. You discussed -- do you remember discussing</p> <p>9 the -- the split-strike conversion strategy again?</p> <p>10 MR. REGAN: Objection.</p> <p>11 You can answer.</p> <p>12 THE WITNESS: I don't recall.</p> <p>13 BY MR. BLEICHMAR:</p> <p>14 Q. What was your impression of Mr. Morenes, or</p> <p>15 Mrs. Botin's husband, at the first meeting?</p> <p>16 A. He was -- I believe either had his own</p> <p>17 fund or was a professional. I don't -- I don't</p> <p>18 think he was related to the bank so much, but he</p> <p>19 was some sort of a money manager or a fund</p> <p>20 manager or a head -- some -- some -- I believe,</p> <p>21 something like that. That's my recollection.</p> <p>22 Q. And what was your impression of him, in</p> <p>23 terms of -- you said that you were very impressed by</p> <p>24 Mrs. Botin.</p> <p>25 A. He was -- you know, he was sort of --</p>	177	<p>1 me for, you know, seeing these people, and, you</p> <p>2 know, having the meeting and so on.</p> <p>3 Q. Let me go back to Exhibit 1 and to the</p> <p>4 picture. Have you met or do you recognize anyone</p> <p>5 else in this picture that you believe you have met</p> <p>6 with?</p> <p>7 A. This fellow here seems -- looks familiar</p> <p>8 to me.</p> <p>9 Q. And, for the record, are you pointing to</p> <p>10 the fellow to the right of Ms. Botin?</p> <p>11 A. Yes.</p> <p>12 Q. And -- and why does he seem familiar?</p> <p>13 A. He just looks familiar to me. I -- I</p> <p>14 thought I possibly met with him at one of the</p> <p>15 meetings.</p> <p>16 Q. Do you see that below his name, at least in</p> <p>17 the picture, he's identified as Mr. Rodrigo</p> <p>18 Echenique Gordillo?</p> <p>19 A. Yes.</p> <p>20 Q. Does that refresh your recollection as to</p> <p>21 whether you met with him?</p> <p>22 A. No.</p> <p>23 Q. Okay. Anybody else in the picture that you</p> <p>24 recognize --</p> <p>25 A. Well --</p>

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178	<p>1 Q. -- that you --</p> <p>2 A. I --</p> <p>3 Q. -- have met with?</p> <p>4 A. On Thanksgiving of 2008 I met with one</p> <p>5 of the directors of the bank. He came up and --</p> <p>6 he came up with a group of people.</p> <p>7 Q. Uh-huh.</p> <p>8 A. I don't see him here. At least -- you</p> <p>9 know, it -- I don't recognize him from this</p> <p>10 picture, but he was -- I remember that at that</p> <p>11 meeting -- and he came up with a younger fellow,</p> <p>12 who was actually, I believe, took the place of</p> <p>13 Manuel.</p> <p>14 Q. Does the name Mr. Esteban Estevez --</p> <p>15 A. I think so.</p> <p>16 Q. Okay.</p> <p>17 A. He was a handsome, young guy.</p> <p>18 Q. I'll represent to you that Mr. Estevez --</p> <p>19 A. Okay.</p> <p>20 Q. -- replaced Mr. Echeverria.</p> <p>21 A. Right.</p> <p>22 Q. I can also represent if -- if it -- if it</p> <p>23 refreshes your recollection, that our understanding</p> <p>24 is that it was Mr. Echenique who was present at the</p> <p>25 Thanksgiving day meeting.</p>	180	<p>1 for me to meet, you know, to do some due</p> <p>2 diligence or, you know, to meet me.</p> <p>3 Not that he did any due diligence, quite</p> <p>4 frankly, other than what everybody else does,</p> <p>5 just meet me.</p> <p>6 But there was some -- my recollection</p> <p>7 was that someone said it was important for me to</p> <p>8 meet him, because he's in charge of this issue,</p> <p>9 whether there was going to be some sort of a</p> <p>10 vote as to whether to expand the business or</p> <p>11 something of that sort.</p> <p>12 But at that time it was -- there was</p> <p>13 sort of -- a lot of changes taking place in the</p> <p>14 bank. There was -- there was a rumor that they</p> <p>15 were going to be taken over, they were going to</p> <p>16 merge, they were going to get rid of -- or they</p> <p>17 were going to get rid of their money management</p> <p>18 position or --</p> <p>19 You know, there was all sorts of stuff</p> <p>20 that started basically when Manuel left, but</p> <p>21 everybody assured me that nothing was going to</p> <p>22 change.</p> <p>23 So they wanted me to meet with this --</p> <p>24 with this fellow, and I said, fine.</p> <p>25 Q. So your understanding was that there was --</p>
179	<p>1 The picture may be different than the</p> <p>2 one --</p> <p>3 A. Echenique.</p> <p>4 MR. REGAN: Objection.</p> <p>5 Go ahead.</p> <p>6 I thought that you were going to represent</p> <p>7 that he was handsome.</p> <p>8 THE WITNESS: Okay. I can't remember any</p> <p>9 of these guys, but I think at that meeting there</p> <p>10 were three or four people.</p> <p>11 BY MR. BLEICHMAR:</p> <p>12 Q. Okay.</p> <p>13 A. It was an unusual meeting, because it</p> <p>14 took place on Thanksgiving. My office was</p> <p>15 closed. It was a meeting that was -- had been</p> <p>16 delayed, canceled a number of times, because his</p> <p>17 plans changed of being in New York, this one</p> <p>18 director.</p> <p>19 And the purpose of that meeting was</p> <p>20 that -- there was something about they were --</p> <p>21 leverage that they were -- I think it was -- it</p> <p>22 was --</p> <p>23 I was led to believe that this -- there</p> <p>24 was something coming up at the board meeting at</p> <p>25 the bank, and that he was an important person</p>	181	<p>1 I don't know how you put it, but there was something</p> <p>2 going on with -- at the -- on the board with respect</p> <p>3 to investment?</p> <p>4 A. I thought there was --</p> <p>5 MR. REGAN: Objection.</p> <p>6 You can answer.</p> <p>7 THE WITNESS: I thought that -- my</p> <p>8 recollection was that there was -- it was</p> <p>9 important for me to meet him as a board member,</p> <p>10 because, you know, there was some decision, you</p> <p>11 know, as to maybe whether to expand the amount</p> <p>12 of money that I had with them or not.</p> <p>13 That's all I -- that is just, you know, a</p> <p>14 feeling I had.</p> <p>15 BY MR. BLEICHMAR:</p> <p>16 Q. And when did you -- what was discussed at</p> <p>17 that meeting, at the Thanksgiving 2008 meeting?</p> <p>18 A. The same as discussed at every meeting.</p> <p>19 Sort of a replay of -- at that time the markets</p> <p>20 were in turmoil in general. There were</p> <p>21 redemptions sort of flowing around the whole</p> <p>22 industry.</p> <p>23 The industry was in a -- the whole hedge</p> <p>24 fund industry, as well as the market, was sort</p> <p>25 of in -- in turmoil. So it was really sort of a</p>

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183	<p>1 Q. So did Optimal's request to withdraw funds 2 in November of 2008 contribute to the demise of 3 BMIS?</p> <p>4 A. Yes.</p> <p>5 Q. In what sense?</p> <p>6 A. Well, at that time I was getting 7 withdrawals from everyone. With -- I mean, 8 there was a liquidity issue coming in -- going 9 on in the hedge fund industry, and everybody was 10 withdrawing money.</p> <p>11 And because I was one of the few hedge 12 funds that didn't have any restrictions of 13 withdrawals -- you know, there wasn't particular 14 dates they could sort of withdraw the money on 15 demand, which was one of the big attractions of 16 these hedge funds.</p> <p>17 There was no 30-day notice or anything 18 of that sort. Which was typical. Usually there 19 was a timeframe that you couldn't -- you had to 20 withdraw money at the end of a quarter or so on. 21 With me, there wasn't.</p> <p>22 It was sort of like the -- they could -- 23 can withdraw, and did withdraw, you know, at any 24 given time, with no notice, other than, you 25 know, three days settlement type of notice.</p>	185	<p>1 that were new clients that could. So I -- I -- 2 I had the ability to take an additional billion 3 dollars that would have kept me -- that would 4 have covered all of my redemptions, including 5 Banco Santander, but at that stage, mentally I 6 just couldn't.</p> <p>7 I just -- I couldn't handle it any 8 longer. So I just said, you know, I'm not -- 9 I'm just not going to continue. And --</p> <p>10 So I tried to delay -- discourage people 11 from taking money out, like Fairfield and -- but 12 they were all in a position where they -- they 13 had -- they were getting redemptions from their 14 clients, and they had no choice.</p> <p>15 So I realized that, and that was the 16 end.</p> <p>17 So, yeah, I probably said to Optimal, 18 look, if you take money out -- because that was 19 the only threat that I had, was to say, you're 20 not coming back.</p> <p>21 Because what they all did was say, I'm 22 taking money out temporarily, but I'll be back, 23 you know, as soon as I get the money from these 24 other funds, which I can't withdraw until the, 25 you know, 30 days. But as soon as I get that</p>

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186	<p>1 money back, I'm going to re-liquify you.</p> <p>2 And I realized that I just -- it was</p> <p>3 going to be too late, you know.</p> <p>4 Q. How long did this meeting last?</p> <p>5 A. Two hours at the most.</p> <p>6 Q. Two hours.</p> <p>7 Did they ask you about the counterparties?</p> <p>8 A. My guess would be, yes, but I don't</p> <p>9 really -- I can't say for sure.</p> <p>10 Q. Do you remember anything else specifically</p> <p>11 about the meeting?</p> <p>12 A. No. I thought the meeting went well. I</p> <p>13 mean, you know, there was no -- I never -- I</p> <p>14 didn't feel any --</p> <p>15 But, look, you know, everybody was great</p> <p>16 actors, including myself. So it's hard to --</p> <p>17 hard to determine whether they -- what they</p> <p>18 thought.</p> <p>19 I -- I had the opinion that they had no</p> <p>20 choice, that they -- they had to cover these</p> <p>21 redemptions from their clients.</p> <p>22 And they also said they were going to</p> <p>23 replace them, but it was -- other than that,</p> <p>24 there was no difference in that meeting.</p> <p>25 Q. You mentioned that Manuel Echeverria had</p>	188	<p>1 know, I see his picture in the newspaper all of</p> <p>2 the time. So -- as chairman of the bank.</p> <p>3 You know, I -- I thought I had met him</p> <p>4 at one point in time, but, you know, I don't</p> <p>5 know. I don't know whether it was just because</p> <p>6 I've seen his picture or not.</p> <p>7 As I say, a lot of times they -- people</p> <p>8 come up to meetings with me, and I never knew</p> <p>9 really who they were.</p> <p>10 Q. You don't have any specific recollection</p> <p>11 one way or the other?</p> <p>12 A. No.</p> <p>13 MR. BLEICHMAR: Okay.</p> <p>14 (DISCUSSION HELD OFF THE RECORD.)</p> <p>15 BY MR. BLEICHMAR:</p> <p>16 Q. Do you recognize the individual in this</p> <p>17 picture?</p> <p>18 A. (INDICATING.)</p> <p>19 Q. No?</p> <p>20 A. He looks like a drug dealer. I don't</p> <p>21 know.</p> <p>22 Q. We won't identify it, for the record.</p> <p>23 A. Not that I've ever met anyway. No.</p> <p>24 Q. Let me switch gears a little bit. You and</p> <p>25 I have met before; correct?</p>
187	<p>1 been replaced; correct?</p> <p>2 A. Yeah.</p> <p>3 Q. And that Manuel Echeverria had left; is</p> <p>4 that right?</p> <p>5 A. Right.</p> <p>6 Q. What is your understanding of that?</p> <p>7 A. The way it was explained to me was</p> <p>8 that -- by him --</p> <p>9 Q. By Mr. Echeverria?</p> <p>10 A. Yeah.</p> <p>11 -- was that the bank was changing their</p> <p>12 compensation arrangement with him, and that was</p> <p>13 not acceptable to him. They were changing it,</p> <p>14 because there was something internal being done</p> <p>15 at the bank with, you know, how they were going</p> <p>16 to handle things.</p> <p>17 And he -- either he wanted an equity --</p> <p>18 he wanted a percentage, or something, of the</p> <p>19 return, and they just weren't going to give it</p> <p>20 to him. So he left and went to Notz Stucki, I</p> <p>21 guess it was.</p> <p>22 Q. Do you recognize the individual all of the</p> <p>23 way to the right of the picture, the one who is</p> <p>24 identified as the chairman, Mr. Emilio Botin?</p> <p>25 A. Well, yeah. I mean, it's funny. You</p>	189	<p>1 A. Yes.</p> <p>2 Q. And when we've met, who else has been</p> <p>3 present?</p> <p>4 A. Alan.</p> <p>5 Q. Mr. Alan Ellman?</p> <p>6 A. Yeah.</p> <p>7 Q. And can you describe how you and I first</p> <p>8 came into contact?</p> <p>9 A. You sent me a letter, stating that you</p> <p>10 wanted to come up and meet with me about -- you</p> <p>11 were representing some clients in a potential</p> <p>12 action against Optimal and the bank, I guess it</p> <p>13 was, and wanted to know whether I would be</p> <p>14 willing to -- to meet with you. And, you know,</p> <p>15 I said, yes.</p> <p>16 Q. And how did you say, yes? How did you</p> <p>17 contact me?</p> <p>18 A. I either e-mailed you or called you up.</p> <p>19 Q. So we have exchanged telephone</p> <p>20 conversations and e-mails; correct?</p> <p>21 A. Correct.</p> <p>22 Q. How many times have we met?</p> <p>23 A. I believe this is the third time.</p> <p>24 Q. And approximately for how long have we met</p> <p>25 in the past?</p>



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190	<p>1 A. Typically about two hours.</p> <p>2 Q. And generally what did we discuss?</p> <p>3 A. Pretty much a similar conversation to</p> <p>4 what we've been having this morning.</p> <p>5 Q. Anything that you think that we've</p> <p>6 discussed in the past that we haven't covered today?</p> <p>7 A. No.</p> <p>8 Q. What kind of -- when we communicated by</p> <p>9 e-mail, if you could, please, describe how the</p> <p>10 e-mail system works with somebody in a correctional</p> <p>11 facility.</p> <p>12 A. Well, we -- in order for us to contact</p> <p>13 somebody by e-mail, we have to put them -- we</p> <p>14 have to apply, you know, to the -- to the</p> <p>15 prison.</p> <p>16 We have to register a person -- e-mail</p> <p>17 address and -- and who they are and their</p> <p>18 address and so on and what their relationship,</p> <p>19 you know, is.</p> <p>20 At which point I would say, an attorney,</p> <p>21 which would cover -- could be anyone from my</p> <p>22 attorney, to another attorney and so on.</p> <p>23 And you have to -- the person has to</p> <p>24 acknowledge that they want to receive the</p> <p>25 e-mail. And once they do that, then you're</p>	192	<p>1 swore to tell the truth; correct?</p> <p>2 A. Correct.</p> <p>3 Q. Why should we believe that you're telling</p> <p>4 the truth now?</p> <p>5 A. Well, first of all, I have nothing to</p> <p>6 lose by telling the truth. And if, in fact, the</p> <p>7 bank or the fund acted improperly, then, you</p> <p>8 know, I feel it's my obligation basically to --</p> <p>9 to say that.</p> <p>10 It's not going to be my -- you know, I'm</p> <p>11 not going to be the one to determine that,</p> <p>12 obviously, but, you know, basically I've been</p> <p>13 willing to see anyone that's requested -- you</p> <p>14 know, whether they be a defendant's lawyer or a</p> <p>15 plaintiff's lawyer, I have been willing to see</p> <p>16 them.</p> <p>17 So as to whether or not to believe me or</p> <p>18 not, you know, I -- I have no ax to grind, you</p> <p>19 know, one way or the other.</p> <p>20 Q. When you say you have nothing --</p> <p>21 A. Other than do the right thing. You</p> <p>22 know, I'm not sure what is the right thing any</p> <p>23 longer, but, to me, I'm -- my feeling is people</p> <p>24 are going to ask me questions.</p> <p>25 I'm going to answer them, you know, to</p>
191	<p>1 registered to receive and send e-mails to me.</p> <p>2 Q. And is there a name for this system?</p> <p>3 A. It's called the CorrLinks system.</p> <p>4 Q. So is it an Internet-based system?</p> <p>5 A. Yeah.</p> <p>6 Q. So, in other words, you don't have an</p> <p>7 Outlook e-mail account in a computer?</p> <p>8 You access the Internet and your e-mail</p> <p>9 through CorrLinks; correct?</p> <p>10 A. Correct. I mean, we can't use the</p> <p>11 Internet, other than for internal prison matters</p> <p>12 and just to go in and out on an e-mail.</p> <p>13 And all of the e-mails are reviewed</p> <p>14 by -- my e-mails, anyhow, are monitored by -- by</p> <p>15 the Bureau of Prisons.</p> <p>16 Q. Have we offered to pay you any -- in any</p> <p>17 way to appear at this deposition?</p> <p>18 A. No.</p> <p>19 Q. Have we promised you anything of value?</p> <p>20 A. No.</p> <p>21 Q. Have you entered into any agreements with</p> <p>22 me or my firm or anyone in connection with this</p> <p>23 deposition?</p> <p>24 A. No.</p> <p>25 Q. You -- when we began this deposition, you</p>	193	<p>1 the best of my knowledge in a truthful manner,</p> <p>2 because it's -- I feel at this stage of the game</p> <p>3 it's -- it's what I want to do.</p> <p>4 Q. Is there anything else that you would like</p> <p>5 to add?</p> <p>6 A. No, not -- not really. Nothing that I</p> <p>7 can think of.</p> <p>8 MR. BLEICHMAR: Let's go off the record.</p> <p>9 (RECESS FROM 12:36 P.M. TO 12:44 P.M.)</p> <p>10 MR. BLEICHMAR: Back on the record.</p> <p>11 BY MR. BLEICHMAR:</p> <p>12 Q. Mr. Madoff, we -- I just have a few more</p> <p>13 questions.</p> <p>14 A. All right.</p> <p>15 Q. Not a lot more.</p> <p>16 We previously talked about your firm being</p> <p>17 technologically advanced; correct?</p> <p>18 A. Uh-huh.</p> <p>19 Q. When BMIS sent the trading records to</p> <p>20 Optimal, did it send them electronically or a paper</p> <p>21 copy?</p> <p>22 A. Paper copy.</p> <p>23 Q. And why didn't BMIS provide electronic</p> <p>24 trading records?</p> <p>25 A. With the exception of -- of Citgo, who</p>

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194	<p>1 was the custodian for Fairfield, we sent 2 everybody just paper copies of the 3 confirmations. 4 Primarily we didn't want to have -- 5 we -- we were very concerned about anybody 6 having a direct access to our computer system 7 for -- you know, for -- I forgot what the term 8 is, but we didn't want -- we didn't want people 9 having access to our system. 10 So, other than our wholesale clients, 11 who had order execution capability through our 12 system, we didn't have any -- we didn't want 13 anybody else to -- to have -- 14 Q. Did Optimal ever -- 15 A. -- access. 16 Q. Sorry. Are you finished? 17 A. No. That's it. 18 Q. Did Optimal ever raise -- or find it odd 19 that you were providing paper copies when you 20 were -- when BMIS was known as a 21 technologically-advanced company? 22 A. Well, I would say that they all would 23 have preferred to have that. First of all, 24 it -- it was a cost issue for them. It saved 25 errors on their part.</p>	196	<p>1 A. No. 2 Q. And did anybody at BMIS generally use 3 e-mail? 4 A. Yeah. Everybody else in the firm used 5 e-mail, other than the advisory side. 6 Q. And how did you -- why not? 7 A. Well, until I came to prison I was very 8 opposed to e-mails in general. I just -- I 9 never had an e-mail -- personally I never had an 10 e-mail address. 11 There was also a -- an issue of the -- 12 the industry was always afraid of e-mails, from 13 day one. They fought having e-mail, because 14 e-mails had to be retained. 15 And I remember sitting on a federal 16 regulations committee meeting, when e-mail -- 17 when the SEC was going to propose requiring of 18 treating e-mails like they did all 19 customer-related information. 20 I remember the then general counsel of 21 Merrill Lynch saying this was going to be the 22 downfall of the securities industry, because now 23 all of this information, all of these 24 communications, which typically in the past 25 could be torn up, you know, are now going to be</p>
195	<p>1 I mean, we -- we -- it was not uncommon 2 for the people receiving -- it was -- it was a 3 manually -- it was a -- it was a, you know, 4 pretty intensive manual operation. 5 I mean, we would send the confirmations. 6 We would actually fax them, because they didn't 7 want to wait for the mail. So typically we 8 would fax them con -- 9 And the confirmations came out typically 10 24 hours after the trade was executed. And then 11 it would be mailed. And -- you know, first 12 class mail, and they would get it. 13 But most of the funds requested to have 14 that information faxed to them that day. So 15 they would get -- get it like within 48 hours. 16 And then their -- their -- their 17 clerical people would have to type in, key punch 18 in, to their systems. 19 So it -- in order to them -- to avoid 20 having the key punch operators make mistakes, 21 which they frequently did, it would have been -- 22 it was an -- an easier process for them to -- to 23 get it electronically. 24 Q. Did anyone at -- at BMIS on the investment 25 advisory side use e-mail?</p>	197	<p>1 saved. 2 And it -- they -- he turned out to be 3 correct. It was the undoing of endless amount 4 of -- so -- but that wasn't a concern so much 5 for me. 6 It was just the whole general industry. 7 Nobody wanted their phone calls recorded. 8 Nobody wanted to have e-mails, you know, 9 retained. 10 But most firms lost that ability. We 11 were one of the few firms on Wall Street that 12 were not required to record our trading room 13 conversation. 14 That was because we were one of the few 15 firms that was not involved in the price-fixing 16 litigation in the industry, which required 17 everybody to record their phone calls. So we 18 never had any recording device at all in our -- 19 in our office. 20 As far as e-mails are concerned, e-mails 21 for all employees was a pain in the neck, 22 because they spent all day, you know, on 23 e-mails, on the Internet. 24 We were required -- as a broker-dealer 25 you're required to monitor all of your firm's</p>

198	<p>1 e-mails all of the time, and it was very labor 2 intensive.</p> <p>3 And it had to be done by the compliance 4 department. And, quite frankly, when we 5 monitored our trading room e-mails, it was a 6 total disaster. I mean --</p> <p>7 Q. In what sense?</p> <p>8 A. You can't imagine what -- what people -- 9 you know, not only e-mail, what they do on the 10 Internet. I mean, we had to require -- I mean, 11 everything from these sex 800 e-mails. I 12 mean --</p> <p>13 Q. So it was a liability concern?</p> <p>14 A. It wasn't a liability concern. We 15 had -- my compliance officer, my brother's 16 daughter, who was the -- who was with us, said, 17 I'm not monitoring these e-mails, because, you 18 know --</p> <p>19 I mean, we -- we had -- we had people 20 that were monitoring lesbians-of-size e-mails, 21 you know. It was ridiculous. I mean, we had 22 guys that were, you know -- that's what they do 23 all day long. So --</p> <p>24 And we said, you're not allowed to use 25 e-mail for any personal -- we had -- my</p>	200	<p>1 e-mails, because this was the way they 2 functioned in general.</p> <p>3 So we had very strict rules with it, but 4 we allowed it.</p> <p>5 But the people in the investment 6 management side, they had no reason to have 7 e-mails. I don't need to have your wife tell 8 you to bring home a quart of milk over the 9 e-mail.</p> <p>10 Q. Let me switch topics for -- for a moment 11 and go back to Manuel Echeverria. Over the years 12 Mr. Echeverria was involved in conducting some due 13 diligence over you; correct?</p> <p>14 A. Uh-huh.</p> <p>15 Q. And what was your impression of his ability 16 to conduct due diligence?</p> <p>17 A. You know --</p> <p>18 MR. REGAN: Objection.</p> <p>19 You can answer.</p> <p>20 THE WITNESS: He -- he was typical of -- 21 you know, he -- he sort of knew the questions to 22 ask, which was -- they all knew.</p> <p>23 Most of them, quite frankly -- frankly, had 24 questionnaires that their due diligence people 25 would -- would provide them with to ask.</p>
199	<p>1 secretary was shopping on e-mails all day long, 2 you know, using the Internet, and --</p> <p>3 Q. But you, personally, didn't have e-mail 4 either; right?</p> <p>5 A. I never had an e-mail. I saw -- I was a 6 firm believer -- I returned every phone call 7 anybody ever gave me within an hour after I got 8 it, no matter where I was in the world, no 9 matter who it was.</p> <p>10 I was well known for that. I said, if 11 you want to talk to me, call me up. But make 12 sure it's important. And I'm going to return 13 the call.</p> <p>14 I found that it was common knowledge 15 that -- because I know other people that had 16 e-mails, like my sons and my brother, you know. 17 People fire off e-mails, you know, blast e-mails 18 off to -- you know, with jokes and everything.</p> <p>19 That was the big thing with Wall Street, 20 half of the e-mails going through were jokes 21 that everybody would tell each other.</p> <p>22 So there was nothing sinister in why we 23 didn't want e-mails. I tried to stop it in the 24 whole firm, but my traders, you know, felt they 25 had to have instant messaging. They had to have</p>	201	<p>1 And he understood the strategy. So he was 2 as knowledgeable as anybody else with, you know, 3 the questions he asked and the due diligence he 4 did.</p> <p>5 BY MR. BLEICHMAR:</p> <p>6 Q. Was it your impression that he asked enough 7 questions?</p> <p>8 A. Yeah.</p> <p>9 Q. Did you feel that he was pushy?</p> <p>10 A. No. He was -- he was considerate. In 11 other words, I didn't have to tell him more than 12 twice, or three times at the most, you know, 13 that I would provide or would not provide what 14 it was.</p> <p>15 But it was pretty well laid out from the 16 first meeting what information I would provide 17 and what I wouldn't provide.</p> <p>18 MR. BLEICHMAR: I'll reserve the rest of my 19 time for redirect.</p> <p>20 (DISCUSSION HELD OFF THE RECORD.)</p> <p>21 MR. REGAN: Mr. Madoff, thank you for your 22 time. We -- as you and I discussed briefly 23 earlier, the judge in this case has entered an 24 order that gives each side a day of up to seven 25 hours to depose you. We're going to reserve our</p>

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202	<p>1 opportunity to do that. I'm not certain that we</p> <p>2 will --</p> <p>3 THE WITNESS: Uh-huh.</p> <p>4 MR. REGAN: -- find it necessary, but if we</p> <p>5 do, we will certainly let you know through the</p> <p>6 Bureau of Prisons.</p> <p>7 THE WITNESS: Right. Okay.</p> <p>8 MR. REGAN: Other than that, again, just</p> <p>9 thank you for your time, and we will --</p> <p>10 THE WITNESS: You're welcome.</p> <p>11 MR. BLEICHMAR: We can go off the record.</p> <p>12 (SIGNATURE RESERVED.)</p> <p>13 (DEPOSITION CONCLUDED AT 12:55 P.M.)</p> <p>14</p> <p>15</p> <p>16</p> <p>17</p> <p>18</p> <p>19</p> <p>20</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p>	204	<p>1 ERRATA SHEET</p> <p>2 IN RE: OPTIMAL U.S. LITIGATION</p> <p>3 DATE: AUGUST 7, 2012</p> <p>4 PAGE LINE CORRECTION AND REASON</p> <p>5 _____</p> <p>6 _____</p> <p>7 _____</p> <p>8 _____</p> <p>9 _____</p> <p>10 _____</p> <p>11 _____</p> <p>12 _____</p> <p>13 _____</p> <p>14 _____</p> <p>15 _____</p> <p>16 _____</p> <p>17 _____</p> <p>18 _____</p> <p>19 _____</p> <p>20 _____</p> <p>21 _____</p> <p>22 _____</p> <p>23 _____</p> <p>24 _____</p> <p>25 (DATE) BERNARD L. MADOFF</p>
203	<p>1 ACKNOWLEDGMENT OF DEPONENT</p> <p>2</p> <p>3 I have read the foregoing transcript of</p> <p>4 my deposition and except for any corrections or</p> <p>5 changes noted on the errata sheet, I hereby</p> <p>6 subscribe to the transcript as an accurate record</p> <p>7 of the statements made by me.</p> <p>8</p> <p>9 _____</p> <p>10 BERNARD L. MADOFF</p> <p>11</p> <p>12 SUBSCRIBED AND SWORN before and to me</p> <p>13 this ____ day of _____, 20__.</p> <p>14</p> <p>15</p> <p>16 _____</p> <p>17 NOTARY PUBLIC</p> <p>18</p> <p>19</p> <p>20 My Commission expires:</p> <p>21</p> <p>22</p> <p>23</p> <p>24</p> <p>25</p>	205	<p>1 ERRATA SHEET CONTINUED</p> <p>2 IN RE: OPTIMAL U.S. LITIGATION</p> <p>3 DATE: AUGUST 7, 2012</p> <p>4 PAGE LINE CORRECTION AND REASON</p> <p>5 _____</p> <p>6 _____</p> <p>7 _____</p> <p>8 _____</p> <p>9 _____</p> <p>10 _____</p> <p>11 _____</p> <p>12 _____</p> <p>13 _____</p> <p>14 _____</p> <p>15 _____</p> <p>16 _____</p> <p>17 _____</p> <p>18 _____</p> <p>19 _____</p> <p>20 _____</p> <p>21 _____</p> <p>22 _____</p> <p>23 _____</p> <p>24 _____</p> <p>25 (DATE) BERNARD L. MADOFF</p>

1 STATE OF NORTH CAROLINA  
2 COUNTY OF PERSON

3  
4 CERTIFICATE OF TRANSCRIPT

5  
6 I, Lisa A. DeGroat, a Court Reporter and  
7 Notary Public in and for the aforesaid county and  
8 state, do hereby certify that the foregoing  
9 deposition of BERNARD L. MADOFF, was taken by me and  
10 reduced to typewriting under my direction; and the  
11 transcript is a true record of the testimony given  
12 by the witness.

13 I further certify that I am neither attorney  
14 or counsel for, nor related to or employed by any  
15 attorney or counsel employed by the parties hereto  
16 or financially interested in the action.

17 This the 9th day of August, 2012.  
18  
19  
20  
21

22 \_\_\_\_\_  
23 LISA A. DeGROAT  
24 Registered Professional Reporter  
25 Notary Public #19952760001  
Expiration Date: December 8, 2015

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